August 1957

THE CANADIAN CHARTERED ACCOUNTANT

Debenture Financing for Municipalities

The Problems of Tax Policy

Earnings Statements and Prospectuses

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THE CANADIAN BANK OF COMMERCE
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THE CANADIAN
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IN THIS ISSUE

A. K. EATON

In "The Problems of Tax Policy", A. K. Eaton has emphasized some of the practical problems regarding the scope and effectiveness of taxation as an instrument for controlling the economy. He claims that major changes in the tax structure, as they apply to personal budgets, are disruptive and minor changes relatively ineffective. Timing and ability to see into the future, he suggests, are of the essence in settling fiscal policy. On the other hand, the author readily admits that to predict the future with any degree of success is no easy matter and, therefore, no one should blame a Minister of Finance for a wrong judgment because of his inability to know what may lie ahead.

Dr. Eaton is Assistant Deputy Minister of Finance with the Federal Government at Ottawa. As a member of the Department of Finance since 1934, he has wide experience in matters relating to taxation and has written a number of articles on the subject in professional journals (*C.C.A.*, May 1957). This article is an extract from a paper which he presented recently at the taxation seminar at Queen's University, Kingston.

B. J. B. GALVIN, C.A.

The statement of earnings in a prospectus is an essential part in influencing the investor's decision to purchase the securities offered. While all prospectuses have to comply with certain *minimum* statutory requirements, it is left to the professional auditor to decide what constitutes sufficient information to enable the prospective investor to obtain a fair conception of the company's past earnings. It should be noted also that the Canadian Institute of Chartered Accountants has published a research bulletin (No. 2, April 1947) which sets forth the standards expected of its members and in which it discusses the responsibility of the chartered accountant in reviewing earnings summaries. In "Earnings Statements and Prospectuses", Brian Galvin analyzes a number of published prospectuses and comes up with some interesting differences as to the extent to which actual practice meets both legislative requirements and acknowledged professional standards. He concludes with some suggestions for further adjustments for future practice.

Mr. Galvin is assistant to the director of professional courses at the School of Commerce, Queen's University. He is a member of the Institute of Chartered Accountants of Scotland and, in 1955, was admitted to the Institute of Chartered Accountants of Ontario.

GEORGE F. KILNER, F.C.A.

George F. Kilner's second article "Accounting for Mine Production" deals with those aspects of accounting in the mining industry related to development, construction and production. The construction program is a major part of any project and demands a proportionate amount of attention and planning from the accountant. Mr. Kilner, who is a partner of P. S. Ross & Sons, regards his article merely as an introduction to the subject and points out that most of the features of mine accounting in any of its phases merit individual treatment. On one issue he is em-

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phatic and made this clear in a discussion with the Editor: "It is virtually impossible to prepare reliable accounting reports for a mining company without visiting the scene of action." On this he speaks from personal experience when he outlines some of the accounting controls which are necessary if all the cost factors are to be satisfactorily determined. The author has had more than 25 years experience in all stages of mining development, including investment holding operations.

R. M. GRILLS

So that the security analyst can make wise decisions in selecting or rejecting securities, he needs to find certain types of essential information in his study of financial statements. A policy of over-conservative accounting is deplored as much as under-conservative accounting and, in "The Security Analyst and the Annual Report", Michael Grills lists the principal items which should appear in the financial statements and tells why he considers them to be so important from the investment dealer's point of view.

Mr. Grills' training and experience include a year with Noranda Mines Limited and Canadian Gypsum Company, respectively. He has been with the investment firm of McLeod, Young, Weir & Co. Ltd. since 1953 and is a past president of the Junior Investment Dealers Association, (Toronto Division).

RONALD PARK, C.A.

Most municipalities in Canada have experienced phenomenal growth since the end of World War II which has resulted in increasing demands for additional public improvements,

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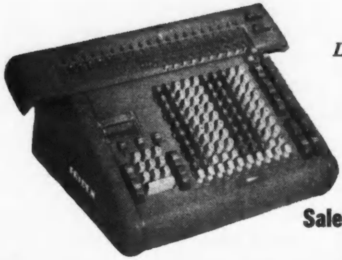

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such as schools, streets, sewers, playgrounds and many other facilities. Everything points to a continuance of this situation, involving the expenditure of large sums of money, so that, according to Ronald Park in "Debenture Financing for Municipalities", a sound debt management policy and the preservation of a municipality's credit are its most valuable assets. The author deals with two types of debenture which are issued by Canadian municipalities, examines the way they are placed on the market in order to sell them at the most favourable terms, and discusses some of the features of borrowing where bond issues are sold in the United States.

Mr. Park is comptroller of the City of Saint John, New Brunswick. He was formerly with Ross, Frewin, Reevey & Co., which later merged with Peat, Marwick, Mitchell & Co. He was admitted to membership in the New Brunswick Institute of Chartered Accountants in 1947 and, from 1952 to 1954, was secretary-treasurer of the Institute.

B. S. CREIGHTON, C.A.

Accountants have a responsibility to provide protection and maintain adequate records in any organization to which they belong, and almost every accountant, at some time or another in his career, is asked to manage the financial affairs of a local club or association. In "Management Controls in Club Accounts", B. S. Creighton advances this thought and describes some of the controls that are necessary to see that all revenues and expenditures are accurately recorded. In addition to outlining management's responsibility in preparing adequate information on the year's operations, the author deals also with the benefits that the auditor can offer.

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Mr. Creighton is on the staff of Price Waterhouse & Co., Montreal. He graduated from Dalhousie University in 1948 and is a member of the Institute of Chartered Accountants of Nova Scotia, having served, until recently, on the Council of that Institute.

EDITORIAL

The rapid growth of business during the past fifteen years has resulted in an ever expanding pool of potential managers; persons with backgrounds, experience and maturity, necessary for careers in management. Where then does the chartered accountant fit into the counsels of management? Is his contribution as great as it might be? What steps of an essential nature are being taken to see that the profession broadens its functions and strengthens its traditional concept of rendering service? In this month's editorial "The Accountant in Management", E. H. Banks refers to the tendency of the accountant to "stick to his knitting". He suggests ways and means whereby he can be brought into closer touch with general management and cites, as an example, what is being done by the engineering profession. This thought provoking editorial should be of considerable interest to those who are continually giving so much of their time to studying the policies and programs of the profession.

Mr. Banks is assistant general manager and comptroller of the Hydro-Electric Power Commission of Ontario and former comptroller of Defence Industries Limited and secretary-treasurer of Atlas Steels Limited, Welland. He joined the Hydro in 1947 as comptroller and, in 1955, was assigned the additional responsibility of assistant general manager. Mr. Banks is a member of the Institute of Chartered Accountants of Ontario and, in 1956, was elected a Fellow of the Institute. He is also a member of the Canadian Club and the Toronto Board of Trade.

FORTHCOMING FEATURES

THE DECISION TO "GO ELECTRONIC"
A Survey

LISTING REQUIREMENTS ON CANADIAN STOCK EXCHANGES
A. J. Trebilcock

TIME CLOCKS FOR THE HOURLY PAID EMPLOYEE?
T. S. Morse & A. H. Howson

LETTER TO THE EDITOR

Montreal, July 10, 1957

Sir: Mr. Beevor is to be complimented for his excellent article on financial public relations which appeared in the July issue.

A big step in the direction of the methods suggested by Mr. Beevor was realized when Chas. Pfizer & Co., Inc., the pharmaceutical and chemical firm, presented its 1956 annual report as a 16-page supplement to the Sunday editions of three major U.S. newspapers, including *The New York Times*. This medium permitted the report to reach an estimated 3,500,000 readers, and Pfizer's new approach to financial journalism caused world-wide comment, both in the press and elsewhere. The format of the supplements was the same as that of the report sent to the shareholders and to employees all over the world.

There is no doubt that much could be done by Canadian companies to improve their financial public relations, even without matching the scale used by Pfizer.

GEORGE SIMONS, C.A.

Mr. Simons is chief accountant with Pfizer Canada, Montreal.

NOTES AND COMMENTS

American Institute Change

The American Institute of Accountants changed its name on June 1 to the American Institute of Certified Public Accountants. The purpose of this change is to emphasize the fact that membership in the Institute is limited to those accountants who have been granted C.P.A. certificates by their respective states.

The American Institute was originally incorporated in 1887 as the American Association of Certified Public Accountants, the first organized body of accountants in the United States. In 1917 it revised its charter to require a written accounting examination for all new members and changed its name to the American Institute of Accountants. Now as the American Institute of Certified Public Accountants, its new name signifies its responsibility for accountancy practised at the professional level.

Women in the Labour Force

At the end of 1956, reports the The Canadian Bank of Commerce Commercial Letter, there were approximately 1,390,000 women in the Canadian labour force. This figure is 24% of the total force of 5,741,000. Of these working women, more than 40% were married.

Ninth Award Won

The annual report of The British American Oil Company Limited has received its ninth consecutive Merit Award from *Financial World,* a U.S. magazine which conducts an annual report contest.

Accountant M.P.'s

Four members of the accounting profession were returned to Parliament in the federal elections of last June. J. Waldo Monteith (P.C.-Perth) and Allister Stewart (C.C.F.-Winnipeg North) are chartered accountants, while Mrs. Ellen Fairclough (P.C. - Hamilton West) is a member of the Canadian Institute of Certified Public Accountants. Auguste Maltais (Lib. - Charlevoix) is also an accountant. Mrs. Fairclough, appointed Secretary of State, is the first woman to be named to the Cabinet.

In the News

Winner of the Governor General's gold medal in 1956 for the highest marks in Canada in the final examinations, EDWIN C. HARRIS, C.A. was awarded the Nova Scotia Barristers Society Scholarship and the Carswell Prize for obtaining the highest average in second year Law at Dalhousie University.

A. M. HENDERSON, O.B.E., C.A. (Ont., Que.) presented a paper entitled "A Quick Look at Canada's Natural Resources" to the Joint Canada-U.K. Committee of the Canadian Chamber of Commerce and the Associate of British Chambers of Commerce at Bournemouth, England on June 3, 1957. Mr. Henderson is chairman of the Executive Council of the Canadian Chamber of Commerce.

WILLIAM HOGBEN, C.A. (Ont.), has been appointed financial advisor to the Board of Transport Commissioners, Ottawa.

Editorial

THE ACCOUNTANT IN MANAGEMENT

IT HAS BEEN well said that a sense of public responsibility is one of the hallmarks of a profession. The word "management" has come to describe what may be thought of as a professional class functioning in an enterprise between the owner on the one hand and labour on the other. The need for closer harmony between the aims and objectives of the employer and the employee and the associated responsibility to the public has brought this profession into being.

This type of management activity frequently lacks much of the colour associated with the entrepreneur of former days – from newsboy to successful head of the enterprise. While less colourful than the intuitive management of years ago the job has become infinitely more important because of the greater complexity of business life, competition and labour relations. To cope with this requires considerable administrative skill and careful planning. Even greater skill will be needed in the future to cope with such things as the development of automation to the optimum degree possible with a minimum disturbance to personnel. As a field of activity modern management, with all its headaches, has an attraction to enterprising men and it has been entered by many professionals.

Much has been written about the accountant's position in the councils of management. His contribution in the area of finance, economic analyses of such things as plant expansion and production levels has long been recognized. His contribution through industrial costing to solving the problems of product cost, product mix and prices is undisputed. It is evident from papers that appear from time to time that the degree of participation in these areas varies from industry to industry and from company to company.

Not so much has been written about his greater potential in the area of general management, requiring as it does skills in effective organization, employee development and methods improvement. It is fair to say that in managing operations in the fields of engineering, construction, production and sales, more emphasis is required on

these latter skills than is so in the basic service of accounting. For this reason there is a natural tendency to assume that these areas normally provide the successors in the broader management field of the enterprise. This tendency has been aided and abetted by the accountant's inclination to "stick to his knitting" and restrict his development to the purely economic aspects of management. This is to be regretted.

In actual fact his training gives him a head start in the broader field but he sometimes falls short in training relating to organization, human relations and labour relations. Fortunately such training in administrative techniques may be readily obtained as there are available many university courses which may be taken on either a full-time or extension basis. Furthermore, many business associations conduct management conferences, seminars and courses. Engineers, production men and salesmen have been quick to take advantage of these activities for their further development and in at least the engineering profession some business administration has been worked into university training. It is time that accountants become equally active. Courses timed before or after graduation might be promoted.

The Institutes of Chartered Accountants with their triple responsibility to their members, the profession and the public might find in this thought some cause for action – action which could be justified as it would be of considerable advantage to the professional accountant. He would receive formal indoctrination in management philosophy and training in administrative techniques and so would be able to render a better management consulting service to his clients and possibly to a greater number of clients. Furthermore, this broadened scope would appeal to young men coming up through high school and university and would thus enlarge the source of possible candidates for membership. Those members who look toward a career in industry would have greater opportunities which would mean a larger flow of men through the profession. This would be beneficial, providing as it does new blood – good for any organization.

Debenture Financing for Municipalities

RONALD PARK

CANADIAN MUNICIPALITIES have been substantial borrowers in the past and, faced with a rapidly increasing population, will continue to be for many years to come. Monetary conditions during the past year have made many Canadian citizens very much aware of the cost of borrowing money, so that a superficial examination of the considerations involved in municipal debt management should be of timely interest. The power to borrow is a precious asset and only the establishment of a sound policy of debt management will maintain and develop it.

The authority to borrow and the conditions under which a municipality may borrow are set forth by statute. In some provinces there is a statutory limitation on the amount of debt which may be incurred by a municipality, but in spite of such limitations there is considerable scope and need for the exercise of sound judgment. It is upon the municipal officials that this responsibility must lie.

Purpose of Borrowing

Municipal long-term borrowing should never be resorted to for the purpose of ordinary current expenditure. Its normal purpose is to finance capital expenditure, but sound debt management does not approve the financing of all capital expenditure in this way. Moreover, the distinction between capital expenditure and revenue expenditure often cannot be clearly drawn. Capital projects that are large and costly in relation to a municipality's financial resources, if they have a relatively long useful life and are not of a frequently recurring nature, are proper subjects for bond issues. This method of paying for improvements spreads the tax burden over a long term, close to the useful life of the assets acquired, and so facilitates expenditure which would be prohibitive if imposed in any one year. This is closely akin to the practice, so much a part of family life today, of buying on time. The same risk is present: can the borrower keep up the instalments?

Many capital expenditures of a municipality recur from year to year. In a small community the most common example is that of automotive equipment which has a short working life of three years or so, but in a large city recurring expenditure often could extend to assets which individually have a long life such as additions to

utility distribution systems. A prudent borrowing policy will exclude these types of recurring capital expenditure because their inclusion inflates the funded debt by deferring payment for them.

The formulation of a sound debt management policy should include the planning of recurring capital expenditure five to ten years ahead with the object of including the requisite one year's share of recurring capital cost in the annual operating budget. Borrowing will then be confined to the financing of large, non-recurring expenditures and can be undertaken under the better conditions of a lower existing funded debt and the less frequent marketing of debentures.

In addition to the normal purpose of borrowing for capital expenditures, it is permissible to borrow for the financing of abnormal, heavy expenditure of a current nature during a state of emergency. In the 1930's some Canadian municipalities financed relief expenditure in this way. If a sound policy of debt management has been followed, a municipality will have built up a good credit reputation and in such an emergency will be able to borrow without difficulty and with confidence. The possibility that a municipality may some day be faced with a situation of this sort should encourage the adoption of a conservative borrowing policy in normal times. In this regard conservative municipal officials often find their opinions in conflict with those of the governing body.

Statutory Requirements

The power of Canadian municipalities to borrow by the issue of debentures is conferred by provincial statute and there are many variations among provinces in the requirements of the statute.

In general, a debenture by-law requires the approval of the majority of the electors. In several provinces some control over borrowing is imposed by requiring the consent of the provincial municipal affairs department to the debenture by-law. Some of the older Canadian cities have the privilege of issuing debentures without requiring the consent of their respective provincial legislatures.

In several provinces the statutes impose conditions under which debenture debt may be incurred. They may limit the rate of interest, impose a limit on the amount borrowed, or stipulate maximum terms of years for the debentures according to the purpose of the expenditure involved. Limits on the amount that may be borrowed are determined in different ways including the following:

1. A percentage of taxable immovable property, a higher percentage being permitted for cities, a lower one for towns, and a still lower for villages and rural districts.
2. A stated amount per capita, the amount being graduated downward from cities to rural districts.

The aim of the statutory restrictions, whatever their form, is to deter or prevent municipalities from borrowing beyond their capacity. There is no precise standard for the limit of debt that a municipality can reasonably afford to carry, as is evident from the variety of limits imposed by different provincial statutes.

The debt of a municipality is usually expressed as an amount per capita for the purpose of comparing with other municipalities. Comparisons with other municipalities must be made carefully because in most areas

there is considerable overlapping of local governmental bodies, and in the overlapping there will be found variations between areas even in the same province. Even though a liability is not a direct or contingent one of a particular municipality it must not be ignored for debt comparison purposes. Comparisons of the amount of debt per capita must be confined to municipalities of similar size and type, and allowance must be made for the portion borne by self-supporting utilities.

Type of Debenture

Two types of debenture are issued by Canadian municipalities, the sinking fund (or term) bond and the serial bond. The first type derives its name from the method of providing for repayment of the principal borrowed. The authorizing by-law provides that during the term of the debenture the municipality will each year out of taxation raise the amount needed to meet interest on the bonds together with a further amount which, set aside and invested, will at maturity produce the principal sum to be repaid.

In the case of serial bonds, a portion of the whole debenture issue is repaid each year. The principal to be repaid each year is raised from annual taxation, hence no fund for the repayment needs to be set up. The amount of principal to be repaid each year can be arranged to suit the municipality and the purposes for which the debentures were issued. Straight serial bonds, in which an equal amount of principal is repaid each year over the life of the issue, involve a progressively reducing annual cost as the interest on the outstanding principal diminishes. This tends to equalize increasing maintenance costs as the respective assets increase in age. Serial annuity bonds, in which the amount of principal repaid each year increases progressively so that the combined sum of principal and interest paid each year remains constant, avoid the high cost in the early years of a debenture issue. A further variation provides for only a token repayment of principal in the early years. Each type has its merits according to the nature of the development. The straight serial type is suitable where comparatively heavy maintenance costs are involved with increasing age and wear and tear. The annuity serial type is suitable to an established municipality where it is desired to avoid wide fluctuations in the annual tax rate. The further variation of this type is suitable for a utility that starts with much reserve capacity and anticipates growth.

Over the past 20 years, the trend has been toward the serial type of bond because of the disadvantages accompanying the sinking fund bond. The annual sum to be invested in the sinking fund has to be calculated on an estimated earning basis. Only the experience of subsequent years will show whether the estimated rate of earning was high or low, by an annual comparison with the actuarial computed earnings requirement. Any appreciable variation experienced by comparison with the estimate necessitates a revision of the annual sum to be invested. Though the principle involved is straightforward, the annual recomputations become burdensome by the time a municipality has a number of sinking fund issues outstanding, each at a different stage towards maturity.

A further disadvantage of the sinking fund bond is that of finding suit-

able securities in which to invest the annual instalment. Investments must be selected which themselves mature around the same time as the bonds which they are to repay. If the investments are not matched with the bonds in this way a heavy loss might be suffered by having to sell investments before maturity at a time when market conditions are poor.

One further complication which might arise in matching investments with their related sinking fund debentures will be dealt with later under U.S.A. financing.

Selection of the type of debenture to be issued calls for consideration of the nature of expenditure involved, the desirability of avoiding pronounced fluctuations in the annual tax levy, the ability to handle administration of accumulating sinking funds and the marketability of the bonds. The ultimate aim is towards a gradual reduction in the outstanding debt in order to make room for new borrowing and development.

Term of Issue

The safe guide for retiring debenture debt is that borrowing for capital projects should be repaid within the useful life of the asset acquired. The possibility of obsolescence as well as depreciation must not be overlooked. Mention has been made of time limits imposed by some provincial statutes, but these can be regarded only as general guides and often the maximum term should be much shorter. The problem of determining the period of retirement is the same as that of establishing appropriate rates of depreciation for fixed assets in industrial and commercial accounting. It is a problem in which the accountant and engineer join forces. Experience has shown that 20 years is the practical limit for most municipal bonds. Somewhat longer periods may be applicable for permanent installations of water and sewer utilities. Most capital expenditure calls for retirement of bonds within a much shorter period than this, but some statutory requirements are unduly restrictive. It is interesting to note that one of the comments of the Investment Dealers Association in its submission to the Gordon Royal Commission was that "investor acceptance of Canadian municipal obligations will . . . . be encouraged by . . . financing long-life capital works, such as schools, roads and other construction through debentures of a longer term closer to the actual life of the asset acquired".

Expenditure for the few non-capital purposes which may justifiably be financed by bond issues should be the subject of a short-term issue, as funding of the debt so incurred is merely a temporary expedient.

Marketing

The municipality's chief aim in marketing its bonds is to sell them on the most favourable terms.

The investment dealer fills the role of merchandiser of bonds, buying them wholesale and selling them retail. In 1956 Canadian municipalities issued debentures amounting to $399 millions. Business of this size calls for specialists, and there are investment dealers who specialize in the underwriting of municipal bond issues.

The sale of bonds is usually achieved by the municipality calling for sealed bids. The municipality states the total amount of the bond issue,

the proposed coupon rate, the term of the issue in the case of a sinking fund issue or a schedule of annual repayments in the case of a serial bond issue. The notice calling for bids is distributed as widely as possible among dealers, about two weeks or so before the closing date. This period gives dealers time to study the offering and obtain whatever information they need about the municipality upon which to determine their bids for the bond issue.

The information called for by interested dealers is of a searching character, ranging from particulars of the local economy, diversification of industry and the degree of prosperity of the area to comprehensive statistics of the municipality and its finances. In analyzing the statistics presented, the most important consideration is the trend revealed; absolute figures are frequently of no great significance. Statistics required will cover population, assessable values distinguishing between residential, industrial and commercial classifications, tax rate and tax collections, all for a succession of years. Of all statistics considered, the record of tax collections is the most vital to the investment dealer and the investing public. It is the thermometer of financial health, and the municipality's tax collection history is likely to determine whether it can borrow above or below the average cost. Attention is also directed to the comparison of the per capita debt, as previously discussed.

From an appraisal of the community and conclusions drawn from statistics the investment dealer is in a position to decide the retail pricing of the issue in relation to current offerings. Where the issue is of the sinking fund type, involving only one term, only one price needs to be set. In the case of a serial type issue it is usual to set a series of prices graduated from short to long term maturities. Normally these would be on a diminishing scale but during the abnormal conditions of the past year there have been instances in which short term yields have exceeded the longer term.

Having established retail prices, the investment dealer is able to establish his bid for the whole issue making suitable allowance for his profit margin. If the issue is a serial one, computations have to be made reducing the serial maturities to an average term of years for the purpose of computing an average retail price and thence an average bid for the whole issue.

Before deciding to call for bids on an issue a municipality will seek the advice of investment dealers as to the exact timing of the issue, the proper coupon rate (sometimes more than one rate is desirable in the case of a serial issue), form and denomination of the bonds and the places in which they should be payable. Even under the most settled money market conditions, minor fluctuations occur. Careful observation and consultation with dealers assist in the best timing and tend to avoid conflict with other municipal or provincial offerings. Under erratic conditions, such as those of the past year, reliable predictions are impossible. The result is that municipalities and provinces, after calling for bids, sometimes reject them at the closing date in the hope that there will be an improvement in the near future.

One of the features of borrowing during the past year has been the

volume of bond issues of Canadian provinces, municipalities and corporations which have been sold in the United States. The recent Bank of Canada annual report for 1956 shows that of $399 millions issued by municipalities $110 millions were in currencies other than Canadian, and of $2,026 millions issued by provinces, municipalities and corporations, $553 millions were in other currencies.

Selling Issues in the U.S.A.

Some large institutions in the United States make a practice of investing in Canadian bonds. Where Canadian market conditions are difficult, particularly for large borrowings, advantage can be taken of money available for investment in the United States. The initial money cost to the borrower is usually cheaper than it would be in Canada, but the actual money cost cannot be determined until the whole term of the bonds has run and the gains and losses on exchange accounted for. Exchange transactions are involved at the time the bonds are delivered, every half-year on interest remittances, and again on the principal at maturity. With good fortune there will be some gains and some losses, and the borrower takes his chances.

Some steps can be taken, however, to minimize the losses. If the issue is of sinking fund bonds, all maturing at one time, there is the risk of a considerable loss in the case of an adverse exchange at the time of maturity. Theoretically, this can be avoided by investing the sinking funds in securities payable in U.S. funds. In practice it is unlikely that securities satisfying the double requirements of year of maturity and currency of payment can be bought during each and every year that the sinking fund is accumulating. If the issue is of serial bonds, it is unlikely that the exchange will be unfavourable at each annual retirement date and in the years when it is adverse, it only applies to that portion of the issue then maturing.

A further precaution can be taken against exchange losses, by inserting a call clause in the terms of the bonds permitting their retirement at any time after the lapse of, say, ten years or more from the date of issue. The Canadian borrower would take advantage of this privilege during a period of low interest rates in Canada, or when the Canadian dollar is higher than when the issue was made; provided, of course, that the refunding necessary is not too large to be absorbed by the Canadian market.

Conclusion

Canadian municipalities have a happy record of borrowing. Evidence given before the Gordon Royal Commission and the interim report of the Commission point to the large sums that will have to be spent by municipalities over the next two or three decades for social capital requirements to raise facilities to satisfactory standards. Determining what facilities are properly the responsibility of the municipality is a matter of increasing concern to Canadians. The demands of urban growth are likely to result in adjustments in provincial-municipal fiscal relations. Whatever may be the nature of the adjustments, it will only be by a continued adherence to recognized principles of debt management that municipalities will preserve their most valuable asset — their credit.

The Security Analyst and the Annual Report

R. M. GRILLS

To GUIDE investors successfully, a security analyst must make recommendations based on careful study of the most reliable information he can obtain. Complete analytical studies not only interpret the financial position of a corporation but also disclose the condition of the entire industry, the company's relative standing in it, and a great many other factors influencing successful operation and growth.

The fundamental basis of security analysis is the annual report. Its preparation by management and interpretation by investors are of considerable importance in our investment climate. Management is becoming increasingly aware that the existence of a well informed body of security holders is a part of organizational strength and that the annual report is the best vehicle for conveying information. In addition to financial reporting, there are a number of areas of essential interest which management can and should comment upon in the annual report. Some of particular interest are breakdown of sales and sources of profit, inventory position and raw material supply, labour relations, dividend policy, working capital position, source and disposal of funds, plant and properties, investments, research activities, expansion plans, competition, markets, new products and outlook.

The investment dealer is aware that his responsibility to investors continues after he has successfully underwritten and distributed securities. He must keep a watchful eye in order to fulfil his obligation and one of his most important sources of information is the annual report.

Analytical Angles

While security analysis is by no means an exact science, nevertheless a general method can be applied to almost any given financial statement provided that the statement imparts the information which a bond holder or shareholder has a right to expect. Armed with as much information about a company's operations as can reasonably be expected, an investor, or his analyst, is in a position to study and to arrive at an intelligent conclusion regarding the purchase, sale or retention of any of that company's outstanding securities. Without sufficient information, he can become justifiably nervous and disinterested in those securities, thereby contributing to a general lack of market interest.

A security analyst interprets financial statements in a style peculiar to his own breed. Adequate study of statements for investment purposes requires a nature sufficiently inquisitive, and even perhaps sceptical, to drive him to uncover and seek an explanation of those factors which are disturbing or encouraging to him, even though they may have no unusual significance to the reporting company.

An analyst must calculate and study a great many statistical ratios which his experience tells him are useful. He must investigate sales, profits, dividend and surplus policy, depreciation and depletion policy, nature and size of inventory, quality and size of accounts receivable, assets and reserves including hidden if they exist, methods of financing additions and improvements, maturities of funded debt, bank loans, capital structure, status of real property including its valuation, nature and source of surplus and invested capital. Above all, of course, he must be able to recognize the red flag of warning which may appear from the aspect of the safety of a bond or the value of a stock. Accepted accounting principles allow at least some latitude in the statement of results.

An analyst endeavours to interpret the statements, not from an accounting viewpoint, but in a form most enlightening to the investor. In so doing, he will study each item in the statement as it stands individually, in relation to other items, and compared with that of previous reports of the same company. Throughout his investigation, he will pay close attention to his company's behaviour in relation to other companies of similar endeavour, and to the average for the industry. After having arrived at his conclusions on a company's overall operations and outlook, he will then subject the security in question to the tests best suited to it, based on the type of operation and the company's strength.

Following the "Flag"

It bears repeating that the analyst is always on the watch for a "flag" indicating change in a company's circumstances, and management can be very helpful indeed by supplying him with reasonable additional information. Anything which will have an immediate or eventual effect on a security is the analyst's concern, and to fulfil his important function he must be well informed. A weakness or a strong point in a financial statement which he considers to be a flag is not a basis for immediate conclusions and recommendations. It is a starting point from which he carries on, and it is then that he will be found knocking at management's door.

To outline an example of analytical procedure, we might consider a means of studying several integrated oil companies applying comparative analysis towards determining the relative merits of their common shares.

The first step is to gather all available information, the annual reports being, of course, the focal point. The next is to prepare a work-sheet and go to work under the headings shown at the top of the next page.

Equipped with this type of statistical data, together with the additional information with which he must be familiar, an analyst is then prepared to make his observations and form his own conclusions.

Current market
Price range
Indicated dividend
Yield
Earnings per share
Price-earnings ratio

Cash flow per share
Price cash flow per share ratio

Working capital
Gross fixed assets

Depreciation reserves as % gross fixed assets
Total capitalization
% Debt
% Preferred
% Common and surplus

Shares outstanding
Equity per share

EARNINGS STATISTICS

Sales
Income before tax
Income tax
Tax rate
Net profit
Profit as % of sales

Depreciation, depletion and amortization
Depreciation as % of sales
Depreciation as % of gross fixed assets

Earnings per share
Earnings 1st quarter
% Return earned on capital
% Return earned on common

OPERATING STATISTICS

Net production (bbls)
Sales of petroleum products (bbls)
Refinery runs (bbls)
Production as % of refinery runs
Net profit per barrel of product sold
Cash flow per barrel of product sold
Daily refining capacity (bbls)

Crude oil reserves (bbls)
Gas reserves (MMCF)

Valuation of reserves
Oil at $1.00 per bbl.
Gas at 3c per MCF
Value of reserves – per share
Refinery runs per share
Refinery runs per dollar of market value per share (bbls)

Retail sales outlets

Note: Figures and ratios for the past several years should be recorded where applicable. Adjustments should be made for changes in capitalization etc.

Thought Patterns

A few general comments on some of the above headings will indicate briefly the type of thinking involved.

Yield

Currently the shares in the integrated oil group, for example, do not offer attractive dividend income. They therefore must be analyzed for their future prospects for both capital appreciation and dividend increases. When yields of 5% to 5½% are available in good preferred shares, the 2% to 3% offered by growth commons, including the oils, must be considered incidental. Common shares with good growth potential usually sell at comparatively low yields, and conversely high yielding commons are not usually highly rated for growth. The analyst must decide whether the yield is commensurate with value, whether dividend increases can be expected, and in fact whether or not dividends can be maintained in a high yielding situation.

Price-Earnings Ratio

A wide variance is found in this category. One company's shares may be selling at a very high price-earnings ratio compared to others in the same industry, indicating that the market is confident that profits will increase substantially. If the analyst is satisfied that these expectations are justified, he will not be alarmed. If he believes that earnings will not increase sufficiently to bring the ratio into line with others in the same industry, he will exercise caution regarding the shares. Of course, a study of price-earnings ratios must take into consideration accounting policies which affect per share earnings, such as depreciation, depletion and amortization.

Price-Cash Earnings Ratio

This ratio (price related to retained cash before dividends) serves as a better yardstick of earnings for industries in which write-offs play a major role. It is a better "common denominator" than the price-earnings ratio, because it is based on retained cash before write-offs. Cash retained and reinvested in the business is reflected. A comparison of the oil industry shows that price-earnings ratios vary widely while price-cash earnings ratios are more closely in line.

Capitalization

A company's capital structure is of major importance to its shareholders. A heavy funded debt can be very favourable in good times, because the borrowed money can earn more than it costs. On the other hand, that same funded debt could be burdensome in poor times when the assets acquired through borrowed funds cannot be fully employed.

It follows that the shares of a company whose debt ratio is high can be more speculative than one whose ratio is low, and at times more profitable by way of enhanced value because of the greater leverage. An analyst must form his opinion as to when and where a high ratio of debt to capitalization is justified.

An important item sometimes neglected in annual reports is lease-backs, whereby a company sells certain of its assets to investing institutions and then leases those assets on a long term basis. Detailed information on lease-back arrangements should be made available to investors, as they have a distinct bearing on fixed assets and debt figures.

Net Profit as % of Sales

This ratio shows the trend over the years within a company and compared with other companies in the same industry. It indicates management's ability to earn profits and helps to show growth prospects.

Depreciation

Depreciation is of great importance in security analysis and deserves careful attention. Our laws and accepted accounting practices allow management considerable latitude in depreciation policy, and methods used for taxation and reporting purposes have a considerable bearing on net profit.

% Return Earned on Capital

This is another ratio which indicates management's ability – the amount that is earned on capital invested in the company. The trend within the company and the industry is important.

Operating Statistics

Comparative statistics and ratios on the operations of a company or com-

panies are useful to the analyst. Those listed above for the oil industry are self-explanatory. They indicate which company is most fully integrated, has a higher value of reserves per share, makes the greatest profit per barrel of product sold. The analyst can estimate how profits will increase for one company as it adds to its reserves. He can spot a trend of improvement in operations in one company compared with others, or he can estimate the profitability of borrowing to increase refining capacity.

Similarly useful comparisons of operating efficiency can be set up for almost any industry.

These are a few of the areas which the analyst must investigate before he makes his investment recommendations. There are many more, but the method is similar. Gather together all available reliable information; decide what statistics and ratios are needed; calculate and record them carefully, using several years' figures to determine trend or trends; observe the results within the company and compare them to others in the industry; put all the plus and minus factors together and form conclusions.

If any one step in this analytical procedure can be given highest priority, it is the first. Without sufficient reliable information, and to be reliable it should come from the company, there is no starting point. With it the rest falls into place, and logical investment planning is possible.

SHAREHOLDERS' APATHY

I believe that the main cause of the publication of inadequate accounts and reports of public companies is the apathy of shareholders themselves. So long as the customary dividend is received few of them seem to be concerned about the real health of the concern or to go out of their way to ascertain that the money they have invested is in safe hands and reaping the best possible yield. Not one percent of the shareholders in this country attend the annual meetings of their companies in the ordinary way, yet if some refreshment or entertainment is provided at those meetings, the shareholders turn up in large numbers. At one meeting this year an excellent lunch was served on board two steamers during a delightful trip down the Thames and over 3,000 shareholders applied for tickets to attend despite the fact that the chairman was to speak for over an hour.

— Ronald Staples, editor-in-chief of *The Accountant*, speaking at the presentation of *The Accountant* Annual Awards for 1957 for company reports and accounts, June 18, 1957.

The Problems of Tax Policy

A. K. EATON

IN RECENT times tax policy in the popular sense is more likely to be associated with what might be called fiscal or budget policy, implying the use of taxation for control purposes in the business world. In "A Retrospect", written last year when he retired after 17 years as editor of *The Economist*, Geoffrey Crowther gives his opinion that, in domestic affairs, by far the most far-reaching change has been the assumption by the State of responsibility for the condition of the economy. It has happened here too in Canada.

The basic case for a regulatory tax policy is quite simple. Business thrives on consumer expenditure. Taxes take away people's spending money. Ergo, if business needs stimulating, reduce taxes; if business is getting out of hand, increase taxes. This doctrine is known as cyclical or counter-cyclical budgeting.

Although governments love prosperity, they are continually haunted by the fear of a rise in the cost of living. This may be a sign of inflation. Money starts losing its value, and prices may be (a) pulled up gradually by consumer demand, (b) violently jerked up by hoarding or scarce buying, or (c) pushed up by increases in underlying costs.

Taking away purchasing power through higher taxes may help when the price rise is the result of a scarcity of goods in relation to demand. As we have seen, however, increased taxes, can do little to stem panic buying when price increases were such as in the Korean crisis. As for a rise in prices due to the underlying pressure of costs, no one would suggest that siphoning off purchasing power would immediately help matters to any extent. In most instances no one is quite sure whether the price increase is due to the pull of demand or the push of costs. There was an increase in the cost of living last year of about 3%. Who, with any certainty, can say what caused it? Unless the Minister of Finance had a clear answer to this, assuming he knew in advance that the price increase was going to take place, he would be at a complete loss to know whether a tax increase was a right move or not. Furthermore, he would have to bear in mind that a tax increase resulting in a cut in the take-home pay of

An extract from material presented at Queen's University Tax Seminar, June 10-12.

labour might be the basis for a demand for a new round of wage increases. If this did happen, his policy would be doubtly defeated. Consumer demand would be maintained and pressure from the cost structure would have brought about further price increases.

Where there are good grounds for expecting an increase in the cost of living, a restrictive bank policy would still make good sense regardless of whether the pull of demand or the push of costs was responsible, because some restraint on investment plans would reduce tensions in the cost structure as well as slow down the flow of spendable incomes. The point here is that while the proper bank policy would be quite clear the appropriate tax policy would not be obvious by any means. No Minister of Finance, with taxes already at a level to produce a surplus, would increase taxes just on the off-chance that it might possibly be the right thing to do.

Disruptive Tax Changes

One must assume the theory of budgeting for control objectives to imply that fairly substantial increases and decreases in taxes at the appropriate times will be possible and even necessary in order to bring about significant desirable effects. The somewhat light-hearted assumption that programs of this kind could be easily carried out in practice makes one shudder. Taxes are such an important part of family budgets these days that substantial increases or purely temporary decreases could scarcely be tolerated. Most people have to plan their financial affairs quite carefully. Mortgage commitments, life insurance, hospital and medical plans, instalments on the car, furniture and other durables are as a rule arranged with considerable care and thought. Closely calculated family budgets would be thrown into chaos by abrupt changes in taxes. Furthermore, if the government cut personal income taxes sharply to encourage spending the prudent person would automatically put his tax-saving aside and not spend it knowing that before long the government would be back after it and more to recoup its previous deficit. This, of course, would defeat the whole purpose of the cut. Twenty short years ago taxes could have been completely abolished or doubled over-night without creating too much change in anybody's way of life. This is no longer true.

Troubles with Sales and Excise Tax

The disruptive effects of abrupt tax changes apply mainly to personal income tax. People who love the idea of tax controls, however, look with special favour on sales and excise taxes as a means of draining off excess spending power. Here a different set of troubles arise.

Manipulation of sales and excise taxes works fairly well only if the public is not expecting the government to resort to its use. However the public can practically ruin the effectiveness of the policy if it suspects anything.

During wartime we resorted to very high and numerous excise taxes on durable goods of various kinds. Many of these were subsequently abolished and all were reduced in the post-war period. The Korean crisis immediately called for the same pattern of budget policy. Large increases in revenue were needed and it was obviously necessary to divert pro-

ductive resources from wide ranges of consumer durables for support of defence requirements. It was natural that the government should resort to the reimposition of the old excise tax program. The awkward fact was that the same idea occurred to large numbers of the public who bought on a wholesale scale before the 1951 budget was brought down. As a result, there was a bad artificial slump in some lines of business following the budget, not only because of the higher prices due to tax but also because of pre-budget anticipatory buying. Things would not have been too bad if defence orders had been placed the next morning to take up the slack. Through nobody's fault, this was not the case, and there was quite unfortunate disorganization, with unemployment in certain areas at a time when the objective was to make the most efficient use of productive resources.

Owing to the severity of the tax effects, the public expected that the high taxes might not last. That is to say, it held off buying in the expectation of certain taxes coming down or off completely in the next budget. Again it guessed right. All in all, the experience was rather unhappy even though, according to the book, the policy made excellent sense.

Another difficulty in the free use of sales and excise taxes for control purposes is the inventory problem. When taxes are increased dealers with stocks on hand rather promptly mark up their inventory and sell the next day at a price increased by the amount of the tax even though no tax has been paid on the stocks on hand. The government, of course, has no control over prices and can do nothing about it. When taxes are lowered substantially, dealers take an inventory loss on tax-paid stocks on hand. This can be extremely upsetting and even bankrupt weaker firms. Inevitably it causes a flood of representations to the government for relief. The seriousness of this inventory problem is shown by the events preceding the recent budget when, through fear of a lowering of the tax on automobiles, dealers from coast to coast agreed to refuse shipments of cars from the manufacturers. This threatened to cause slowdowns and unemployment in the manufacturing industry. The result was that the Minister of Finance announced ahead of time his intention to amend the law in the forthcoming budget to enable manufacturers to ship cars on consignment without incurring tax liability. Sudden changes in excise taxes can be very troublesome, and experience shows that they are not a very happy choice as an instrument for control purposes.

Gunshot Blasts at Corporations

The corporation income tax as a fiscal instrument does not appear to be too satisfactory. It is pointless to take "purchasing power" away from corporations as is done from individuals with a view to cutting down demand for consumer goods since corporations as a rule are not in the market to any extent for most of these items. A sharp increase in corporate taxes might, of course, result in a smaller subsequent flow of dividends, but it is problematical how far consumer buying in Canada is supported by the spending of dividend income. It is possible, too, that instead of reducing the dividend flow the higher corporate tax might in some cases be passed on to the con-

sumer in higher prices — the very thing the policy was intended to prevent.

It is sometimes suggested, however, that because much capital expenditure is financed out of retained corporate earnings, increased corporate taxes will have a restraining effect on the investment boom which is the main cause of the trouble. It would mean that corporations would have less money to spend. This might make some sense as a policy if all corporations in the country were planning capital expenditure programs. This, however, is by no means the case. Only in some directions are business concerns expanding rapidly. It would be rather difficult to defend a policy which penalized every corporation in order to restrain some who were pressing forward too fast with expansion programs. Taking people's property away from them is a pretty serious business. An attempt to restrain capital investment by a gunshot blast of higher corporate taxes would be both clumsy and unfair.

In attempting to assess the general effectiveness of tax policy as a method of control over the economy it should be remembered that in operating on the flow of purchasing power tax policy is dealing merely with the results of inflation rather than with its causes. In this sense tax policy is no more than a palliative and not a corrective of the fundamental problem. Taking a few hundreds of millions out of the spending stream scarcely touches at all the capital investment program which creates the inflation problem.

To see the problem in perspective, in terms of present day figures, it may be noted that the capital investment spending program in Canada is running at a rate of about $8 billions a year. This flows on and feeds the consumer spending stream practically untouched by restrictive tax policy. Tax policy attempts to deal with the result. Consumer spending at the retail level is currently running at a rate close to $15 billions annually in an economy with a gross national product of at least $31 billions. With personal income tax and sales tax at present yield levels, a 20% increase in the rates of both these important consumer taxes would "sop up" a volume of dollars equal to only about 3% of the volume of retail spending. The leverage is disappointingly small.

The Last Straw

Some may argue that it is this last marginal 3% of spending that is so damaging and vitally important, that this last straw breaks the camel's back and causes the upward move in prices. While there may be some substance to this point it must not be assumed that all or even most prices will always be at the breaking point. The probability is that scarcities will be scattered rather than universal. If so, a large part of removal of purchasing power will have been just a wasted motion in that the spending of much of the money taken away in taxes would not in any case have affected price levels. Tax policy may be taking away a dollar to prevent 29c being spent on goods that are scarce in relation to demand. It is a blunt and clumsy instrument.

Effect of World Conditions

The dependence of the Canadian economy on world conditions cannot but undermine the effectiveness of our fiscal policy. Canadian prices

over wide fields are determined by factors outside our control. In 1951, for example, the last year in which the consumer price index rose so steeply and, incidentally, in spite of a budget calling for tax increases of nearly $600 millions, a breakdown of the separate increases shows a very large part of the total came from higher meat prices which were a direct reflection of higher prices in the United States. The government was still being blamed for not holding down prices.

Mention of the 1951 budget brings out another very awkward problem in attempting to follow what obviously appears to be a sound policy for control purposes. By the spring of 1951 inflation had already made considerable headway although the incomes of the white-collar group and those on pensions and fixed incomes had been scarcely affected. At the same time there was a very large group in the community, mainly industrial workers, whose incomes had kept pace or even moved ahead of the price level. This latter group were the ones that should have been caught by the attempt to decrease purchasing power. Obviously, however, higher taxes had to apply to everybody. Accordingly, a high tax policy to combat inflation, while proper in some directions, inflicted real hardship on other sections of the public.

Skeletons in the Closet

Control budgeting, to be completely successful, calls for wisdom and foresight far beyond that given to ordinary mortals. Timing is extremely important and good ideas do not always turn out right. There are a few humiliating old skeletons in the Ottawa cupboard, an occasional glimpse at which is perhaps good for our collective souls and no one need feel ashamed of their existence.

For instance, during wartime the idea got around in the United Kingdom, the United States and Canada that compulsory saving imposed in addition to income tax would be a sound move. The idea, of course, was to combat inflation by transferring excess wartime purchasing power to fill in the expected deficiency in the post-war period. This, it was hoped, would help ease the economy over the reconstruction period. In order to make a sharp, clear distinction between refundable tax and tax for keeps it was necessary to undertake a definite commitment for the time of repayment of the savings. Even so, many workers never expected to get their money back and, in the meantime, acted accordingly. The legislation was repealed after two painful years. As for the result, there was no post-war slump. On the contrary, we had a severe continuing inflation problem which the repayment of the refundable tax aggravated.

There is another example. To encourage industry in speedy conversion to peace-time production, double depreciation on new investment in the immediate post-war period was offered. This policy turned out badly also and was an embarrassment because the investment boom was already so strong that scarcities were bringing on price rises generally across the board.

What the country needs for fiscal policy is a few fulltime major prophets with a few minor miracle-workers thrown in. They will not be without honour in their own country.

Earnings Statements and Prospectuses

B. J. B. GALVIN

AN INDEPENDENT examination of 30 to 40 published prospectuses, issued in 1954 and 1955, has been made in order to assess how practising accountants report the earnings of companies seeking funds in the capital market and whether the standards of reporting match statutory requirements and the official pronouncement of the profession. The prospectuses, selected at random, were compared with each other and with the published annual financial statements of the issuing corporations. While the sample was not large or comprehensive enough to be conclusive, investigation did point towards some interesting results.

If a prospectus is recognized as a document avowedly written to induce the public to invest its money in the securities of a particular enterprise, it assumes an importance which demands the highest skill and integrity in its preparation. Once the potential investor knows why his money is wanted and who wants it, he is probably more interested in the expected earnings indicated by the prospectus than in any other single piece of information in the entire publication. As past performance often points the way to future results, the earnings statement may well be the crucial factor influencing the investor's decision to purchase the securities offered. Therefore, a heavy responsibility rests on accountants and auditors who prepare and report on the earnings record of either the issuing corporation or of any business to be acquired out of the proceeds of issue.

To assess the manner in which the responsibility has been discharged, it is necessary first to examine the extent to which federal and provincial legislation protects the investor from disarming promoters.

Investors' Statutory Protection

The federal Companies Act requires merely a three year earnings report "year by year" and, further, does not demand any detailed analysis of the profit figures beyond a reference to their nature and source and separate disclosure of "non-recurring" profits. However, all prospectuses, whether of federal or provincial companies, have to comply with the legislation of the province in which the issue is made.

Provincial legislation governing stock issues is contained in the Com-

panies Information Acts and Securities Acts of the provincial legislatures. With the exception of Ontario, the Securities Acts follow much the same pattern as the federal Companies Act. They require a minimum of three years coverage of earnings but give discretion to the provincial Securities Commissions to extend the coverage up to a maximum of ten year. In Ontario, the recently amended Securities Act requires, in effect, a minimum coverage of five years earnings, but gives the Ontario Securities Commission authority to amend this to such shorter or longer period as it considers desirable, up to a maximum of ten years.

As to the analysis of the earnings figures themselves, no hard and fast rules are laid down, but generally information concerning depreciation provided, interest on bond and debenture indebtedness and income taxes are required under all jurisdictions. In each case, the auditor must give his opinion as to the fairness of the assertions made in the earnings report, and in Ontario he must consent to the use of his opinion before filing the prospectus.

The statutes reviewed above are basically "minimum requirements" and leave the professional auditor to decide what in fact is a fair statement of the earnings presented to the public. Individual members of the accounting profession must decide what, in a given instance, is a sufficient period of time and a sufficient analysis of revenues and expenses to enable the prospective investor to obtain a fair conception of past earnings. To guide him in this task, the professional auditor has at his disposal the pronouncements of his profession concerning acknowledged standards of reporting required from its members.

Acknowledged Professional Standards

Research Bulletin No. 2 of the Canadian Institute of Chartered Accountants clearly sets forth its standards for reporting earnings in prospectuses. Briefly, the bulletin recommends a statement of earnings "for a sufficient number of years to give a reasonable picture of the operations of the business" and points out that "the legal requirement of three years earnings under the Dominion Companies Act is usually not a sufficiently long period".

In the case of stock or share issues, the bulletin recommends at least the following minimum analysis of the profit figures: "(a) profits before depreciation, interest on bond and debentures and taxes on income, (b) depreciation provided, (c) interest on bonds and debentures, (d) provision for taxes on income, (e) net profit for the year". In the case of bond or debenture issues, items (d) and (e) may be omitted and interest charges on senior securities included in lieu of item (c); but the bulletin considers this treatment less desirable than full disclosure of all the information noted above.

In general, the bulletin does not favour adjustments to recorded earnings to reflect changed conditions or expected savings. It requires separate disclosure of significant profits and losses of a non-recurring nature, if these have been excluded from earnings.

Actual Professional Practice

In order to try to determine the extent to which actual practice meets both legislative requirements and

acknowledged professional standards, this study was made and the results are discussed below.

PERIOD COVERED

The three year coverage of earnings demanded by the Companies Act (Dominion) and also by the Securities Acts of the provinces (except Ontario, which requires a minimum of five years) is patently considered to be inadequate "to give a reasonable picture of the operations of the business". In nearly every case examined, the earnings report spanned about ten years. The period covered was frequently not exactly ten years because of the stipulation in section 77(3) of the federal Act that the financial reports included in a prospectus must be made up to a date not more than 120 days prior to the date the prospectus is to be issued. Unless the date of the prospectus falls a month or two short of an even ten year period, the tendency seems to be to give a full ten year report and to provide additional figures for a further three to nine months in order to comply with section 77, or with similar provisions under provincial legislation.

When such care is taken to provide a minimum coverage of ten years, and this coverage becomes the standard investors expect, it is open to debate why some auditors permit anything less to appear above their names without giving some explanation. For a business which has been in existence less than ten years, it is, of course, impossible to show more than the results achieved since its inception. But in other cases, investors will rightly want to know why the earnings coverage has been reduced. Unless the prospectus clearly states the reason, misgivings appear inevitable and may operate to the disadvantage of the issuing corporation and, indirectly, the accounting profession. After all, investors, institutional and private, are intelligent persons to whom any form of paternalism is repugnant.

For example, in one prospectus, the opening remarks declared that the business had been established for over 100 years and was "one of the oldest in Canada". The date of establishment was prominently displayed on the cover. However, the earnings report spanned six years from 1949 to 1954. On looking through the company's annual reports, it was found that only a nominal profit was made in 1948, due largely to a $500,000 inventory loss, and that an operating loss of a similar amount had been incurred in 1947. Prior to that, profits ranged between $1,000,000 to $1,500,000 which was about 40% greater than in most of the years mentioned in the prospectus. While it is not suggested that this prospectus was misleading, here is a case where the reasons for not giving a ten-year history might have been usefully stated.

Again, in another prospectus, the earnings record was shown for nine years and nine months. In the year immediately preceding the first year recorded in the prospectus, the company had finally succeeded in getting out of the hands of a receiver who had managed it for over a decade. The facts and the company are so well known that there is no shadow of doubt that the auditors were justified in taking the view that the statement in the prospectus gave a "reasonable picture" of development under new management. However, new generations of investors are continually entering the market, and

the less well-informed amongst them (and also perhaps the unduly pessimistic) might have appreciated some explanation of the circumstances surrounding the receivership period.

Information presented

A prospectus is not designed to rate highly as light bedtime reading. A large volume of statutory and promotional material has to be condensed into a serviceable size. This probably accounts for the overwhelming trend towards a summary of earnings, setting out just the minimum information suggested by Bulletin No. 2.

Most issuing companies tabulate their earnings under half a dozen headings on the lines of those laid out by Bulletin No. 2. Some companies include additional items such as "Other (subsidiary) income" or "Other (general) expenses" when they wish to preserve continuity with their annual income statements and disclose "Sales" instead of "Profit before depreciation, etc." Other companies seeking bond or debenture subscriptions provide an intermediate heading of "Profit before interest and income taxes". In this connection it is noteworthy that no case was discovered which omitted details of income taxes and net profits even though bonds and not stock were being issued. This follows the preferable treatment advocated by Bulletin No. 2.

While perusing various prospectuses, most printed in a uniform medium-blue ink on 8½" x 11½" bond paper, it was difficult to escape the impression that perhaps some of the compilers had sacrified information for uniformity. It is hard to get more than half a dozen money columns across a page of that width without employing very small print. This prompts the question as to whether the earnings summary, as commonly used, is the best means of attaining the purpose of the prospectus, namely, to sell the stock on the basis of the proven performance of the business. There is some merit in the thought that annual income statements are themselves highly condensed summaries of information and to condense them further in the prospectus is to court the risks of oversimplification. That there is no need to "adjust" the information given in the annual income statements is exemplified by a prospectus of The Bell Telephone Company of Canada. Here the compilers virtually reproduced the annual income statements, with suitable amendments to certain items, and succeeded in providing a ten-year record on a page measuring 10" x 7". What is more, this prospectus concerned an issue of mortgage bonds, not common stock.

Adjustments to published annual earnings

Adjustments to published annual earnings for prospectus purposes may be classified as: (1) corrections of errors made or estimates used in preparing the annual reports, (2) regroupings of the detailed information contained in the annual income statements, and (3) adjustments made to "give a reasonable picture of the operations of the business".

Of the three types, the first is usually insignificant (a tribute to the accuracy of accounts) and seldom rates mention in a footnote. The second could, as suggested above, be avoided almost entirely, but practice generally consists of merging all revenues and expenses to produce an amount

of profit before depreciation, interest and taxes. The third is probably the least objective and merits special consideration.

Apart from corrections of errors and estimates, the purpose of "adjusting" earnings is principally to isolate the results of "normal" operations for presentation to the investor. The investor is then often supposed to be able to project past achievements into the future and thereby decide for himself whether the "norm" is likely to be sustained, increased or decreased. It is doubtful, however, if the investor's crystal ball is any more reliable than others, and one is forced to the conclusion that in fact the intelligent investor regards prospectus reports as no more than a guide to the competency of management. Competency in surmounting past problems and making the best use of available resources is generally strong evidence of the likelihood of successful results in the future.

If managerial ability to cope with all business situations is under scrutiny in a prospectus, the adjustments made "to give a reasonable picture" should be comparatively few. The unusual or unexpected situation of today is the commonplace problem of tomorrow; to label it as extraordinary is to narrow the functions of responsible management. It is therefore not surprising that the investigation, so far as it went, revealed few cases where net profits in the prospectus and the annual reports differed substantially.

Most adjustments concerned income tax legislation, although some dealt with "non-recurring" profits and losses, earnings of subsidiary companies and items previously recorded in surplus being returned to income.

One type of tax adjustment stems from the now defunct Income Tax Regulation 1100(4) which readers will recall restricted capital cost allowances to the amount of depreciation provided in the accounts. The consequent distortion caused to reported profits was eliminated in the prospectus by substituting a fair depreciation charge in place of the charge based on maximum capital cost allowance. Another frequent adjustment was made to avoid the hills and valleys in income tax expense, and hence in annual profits, due to provisions of current tax law permitting allowances for plant under construction or allowances inconsistent with accepted accounting principles. (It is debatable whether some of the issuing companies had C.I.C.A. Bulletin No. 10 in mind as this class of adjustment was common before the bulletin was released.)

It appears that accountants are reluctant to classify transactions as "non-recurring" even if they are unusual and out of the ordinary course of activities. Unusually large profits or losses on fixed asset disposals, patent amortizations, significant changes in contingency reserves, etc. were sometimes mentioned in footnotes, but often not. This leads to some curious adjustments. For example, one prospectus offsets a gain (shown in the annual report) which arose from the nationalization of a foreign subsidiary against a loss on sale of investments and included the result as part of "other income" in the earnings summary. Possibly this was merely resigned acceptance of nationalization as a "recurring" risk of doing business with foreigners;

more probably the thought was that the amount involved was not significant.

Meaning of "Significant"

The dictionary defines "significant" as "likely to have an effect". Like many dictionary definitions, this one is inadequate to explain the accounting use of the term. Yet in the preparation of financial reports the word "significant" continually crops up and its interpretation is likely to reflect more individual prejudice than scientific standards. Even if an item is "likely to have an effect" on the reader of the report, it is not easy to surmise what that effect will be and how it will influence his decisions. Accordingly, one may sympathize with those auditors who take a bold view and refuse to regard anything short of momentous as "significant".

If investors are wedded to the earnings summary for prospectus purposes, it is understandable to find widely varying reactions by different auditors to similar situations. For example, some draw attention to non-trading revenues and extraordinary expenses while others in comparable situations ignore them as insignificant in relation to the overall picture.

Each decision to segregate one special factor as "significant" is open to argument; but in the final analysis, each decision reflects the best judgment (and maybe also the personality) of the auditor concerned. To attempt to dictate procedure or slavish adherence to a formula would be to undermine the auditor's main asset, his independent judgment.

Future Trends

One hesitates to dogmatize without strong evidence so that the conclusions offered here are put forward with some trepidation. But if the samples examined and the inferences drawn are valid indicators, it is submitted that future practice may require:

(1) a ten-year history of earnings in prospectuses as a matter of course; or a clear explanation of the reasons for any shorter period, and

(2) the unabridged use of annual income statements instead of the earnings summary; or at least a reconciliation between the two.

The best professional practice in any field has always been well in advance of current legislation, and rightly so. If a profession does not take the lead in its own specialty, then its status as a profession is questionable. The accounting profession is no exception, and it is creditable that the standards set by members in practice go far beyond minimum statutory requirements and even beyond the recommendations of their official representatives. This is not to say there is no room for improvement, particularly in individual cases which fall below the general standard of accomplishment.

Management Controls in Club Accounts

B. S. CREIGHTON

WHILE NUMEROUS articles on current accounting and auditing techniques have been published, few have dealt with features peculiar to business and recreational clubs, fraternal associations and similar non-profit organizations. The dearth of information on the subject is surprising in view of the fact that, at some time in his career, almost every accountant is requested to manage the financial affairs or conduct an independent audit of such an organization.

Control of Club Management

REVENUE

A major weakness in club management is the degree of control maintained over incoming receipts. The importance of this phase of accounting is frequently underestimated by club officials, some of whom exercise extreme caution in their own businesses to ensure that all revenues are accurately recorded. Here are brief examples of controls covering revenue derived from various sources:

1. Revenue from members' fees controlled by requiring the secretary to maintain a members' roll, independently of the treasurer's records, showing the number of members at different rates.
2. Revenue from the operation of a dining-room, bar, etc. controlled through the exclusive use of prenumbered chits, to be signed by members at each of these facilities. Members are billed each month for the chits chargeable to them after the numerical sequence has been accounted for.
3. Contributions controlled by requiring the secretary to forward official receipt forms to donors for amounts contributed during the year as recorded in the treasurer's accounts and on temporary receipt forms.
4. Control over receipts from rummage sales, pantry sales, etc. obtained by not delegating responsibility for these funds to one individual but requiring two members to approve amounts collected and deposited.
5. Revenues derived from concerts, sporting events, etc. controlled through the use of prenumbered tickets subsequently accounted for in cash or unused tickets.

EXPENDITURE

Contrary to the indifference often displayed in establishing effective control over revenue, most associa-

tions maintain adequate safeguards over expenditures. Controls in effect usually require that all disbursements be made by cheque signed by two signing officers and that supporting vouchers be obtained and kept on a separate file. Larger or unusual expenditures normally require specific approval in the club minutes.

Fund Accounting

Many associations adopt a procedure of fund accounting whereby financial activities are segregated into a number of funds each designed for a specific purpose. Provided that the nature of each fund is clearly defined, fund accounting offers an overall control over revenues and expenditures because the division of the operations into smaller segments permits closer scrutiny by club officials. This control may be tightened by delegating the responsibility for operation of the different funds to specific club officials.

Club Audits

Appointment of Auditor

Despite the number of defalcations and mismanagement of funds that receive publicity, many clubs do not appoint auditors to submit independent reports on their affairs. The informal or casual relationship between members tends to minimize recognition of the necessity for an independent check on the administration of the club entrusted to fellow members. Perhaps many of those taking an active part in club affairs have little or no contact with audits or auditors and are unaware of the benefits to be derived from an audit. Whatever the underlying trouble, any organization with funds at its disposal should be brought to realize it must be governed by business principles which include an independent audit of the accounts.

Among the benefits that may be offered to a club through an audit are:

1. Assurance to the members that funds are being properly administered.
2. Protection for club officials by the assurance that their stewardship is in order.
3. Assistance in preparing financial statements.
4. Assistance in solving financial problems.
5. Assistance in gauging the effectiveness of the accounting system and suggesting revised procedures.

Report Requirements

The extent to which controls have been instituted by the club under audit will determine largely the verification procedures to be performed by the auditor. It is not unusual for him to find it necessary to review the entire year's transactions before being able to satisfy himself as to their authenticity. Even then, a complete lack of control may prevent him from forming an opinion and thus necessitate submission of a qualified report.

If, in his examination of revenue, the auditor has been able to verify the major portion thereof to his satisfaction, he may consider it unnecesary to qualify his report in respect of the unverified amount provided he feels there is no reason to doubt its accuracy or validity. However, if the unverified amount represents a significant part of the club's revenue, a qualification is justified, possibly by setting forth the extent of verification work performed, for example:

"In the absence of other means of verification we have accepted the

bank deposits as representing the income derived from rummage sales, teas and concerts."

Verification of club expenditures may prove more satisfying to the auditor than the verification of revenue since, as noted above, most associations maintain adequate safeguards over disbursements and have geared their accounting systems accordingly. A test examination of cheques and vouchers, coupled with a review of previous financial statements and club minutes, may suffice to enable him to form an opinion on the accounts. If dissatisfied with the results of his verification efforts, he must qualify his report.

The emphasis in club auditing is normally placed on verification of revenue and expense rather than of assets and liabilities. This does not mean, however, that the balance sheet should be ignored since it forms an important part of the financial statements and must be reported upon. Its preparation is generally supplemental to the statement of operations as many clubs operate on a cash basis, determining inventory, receivables and payables as a distinct year end function solely for balance sheet purposes.

Probably no other type of audit makes so little compliance with normal report standards. A proper wording of the report, with suitable modification as circumstances dictate, should be adopted.

While the auditor may fulfil his minimum requirements by preparation of the standard short form auditor's report, he will contribute a far greater service to the club by submitting a long form report incorporating comments on weaknesses in accounting procedure and internal control noted during the examination, with suggested means of correction. The significance of weaknesses, particularly those that make possible misappropriation of cash or other assets, should be explained to members in the report.

Financial Statements

In preparing club reports and statements, an attempt should be made to interest an ever-widening circle of the members. Accomplishment of this objective requires the utmost clarity and simplicity of statement presentation. Regrettably, many clubs present to their members hastily prepared sketches of the year's operations, frequently unaudited and sometimes unintelligible. The auditor is in a position to improve this situation, for, even if he does not actually prepare the statements, he normally influences the manner of presentation.

Number and Form

The number and form of the required financial statements depend largely on the nature of the association. They should not follow blindly the pattern of prior years with little or no regard for changed conditions or requirements. Clubs operating on a seasonal basis may require only a statement of receipts and disbursements, prepared on a cash basis, supplemented by a balance sheet. For non-seasonal associations, a statement of revenue and expense prepared on an accrual basis may be preferable in order to gauge more accurately the gain or loss on operations for the period under review.

Presentation

Yearly statements are customarily presented to the members at the annual meeting. Many associations for-

ward copies of statements to members in advance of the meeting (sometimes with notice of the meeting printed thereon), thus giving them an opportunity to peruse the statements before attending the meeting. Members can then prepare in advance for a discussion on the contents of the statements, and greater interest is aroused.

Fiscal Year-End

The selection of an appropriate fiscal year end for each club requires careful consideration. Seasonal associations ordinarily choose a date following shortly after an active season yet sufficiently before the next active season to allow ample time for statement preparation and submission to the members. A golf club would likely select a date between October 31 and December 31, while a university organization would prefer a date between June 30 and August 31. Non-seasonal associations normally prefer a fiscal year end when the association is least likely to be active.

Improving Statement Presentation

Areas in which the presentation of statements might be improved are as follows:

Presentation of Funds

As mentioned previously, many clubs allocate receipts and disbursements during the year to various funds. Some fail to segregate the funds in their statements, resulting in a hodge-podge that even a well-trained accountant finds difficult to interpret. A separate statement of operations (whether on a cash or accrual basis) and a balance sheet should be prepared for each fund. For purposes of clarity, descriptive titles should indicate to the members the nature and purpose of each fund. Transactions between funds should be fully disclosed on the statements.

Segregation of Revenue and Expense by Projects

Revenues are frequently derived from a number of projects against which specific expenses may be charged, e.g. operating a cafeteria or conducting a bowling tournament. On many operating statements, revenues from projects are shown separately from related expenses, the latter being grouped with expenses of a similar nature in other sections of the statement. It is more enlightening, if practicable, to combine related revenues and expenses to arrive at the net gain or expense applicable to each project. Supporting schedules may be prepared for each project with the net result brought forward to the operating statement. Or, if the presentation of revenue and expense detail is deemed unnecessary, the net result may be shown on the operating statement in such a way that the total revenue and expense by project will be evident, e.g. "Revenue from cafeteria sales (less expenses of $6,500) – $740".

Comparative Figures

The use of comparative figures improves the statements and stimulates interest. Care should be exercised that the figures are truly comparable.

Terminology

Confusing and misleading terminology is a common weakness of many club statements. Examples are the indiscriminate use of "surplus" and "sinking fund" when more appropriate descriptions would contribute to the clarity of the statements. Sometimes, too, "profit" is used to describe the "excess of cash receipts over dis-

bursements" when substantial receivables and payables render the term entirely inappropriate.

Clear and concise descriptions accompanied by a logical arrangement of statement material are essential, but the terminology must be familiar to the layman.

ELIMINATION OF UNNECESSARY DETAIL

The average member of an association devotes only a limited time to studying the financial statements. The auditor must be wary of distracting his attention from significant information by crowding statements with relatively unimportant details which could be eliminated or consolidated. Bank reconciliations and listings of receivables and payables are examples of superfluous material.

GENERAL

1. Many clubs follow the commendable practice of prefacing their annual statements with a brief report from the president or directors.
2. A breakdown of revenue from membership fees by the number of members at different rates may be useful.
3. Smaller clubs sometimes fail to include fixed assets on their balance sheets. Where possible, they should be included to avoid the possibility of their being subsequently overlooked.
4. Information should be provided the members concerning details of changes in reserve accounts operated by the club.
5. Inclusion of a budget for the forthcoming fiscal period is strongly recommended as an integral part of the statements. The auditor should encourage greater use of budgets in planning financial activities. Many clubs experience financial difficulties due to a failure to foresee the extent to which revenues will cover anticipated expenditures.

Conclusion

Interesting and varied problems are inherent in club accounting and auditing. The foregoing observations have introduced some features peculiar to club accounts with a view to stimulating interest particularly on the part of the professional accountant.

CONSERVATIVE ESTIMATE

Newly elected prime minister John Diefenbaker has endeared himself to his audiences by his capacity to laugh at himself. This is a quality rare in statesmen and would-be statesmen. Perhaps the most famous of his stories was about the lady in Saskatchewan who, after being persuaded to support him in an election of long ago, answered his question about her husband by saying that Mr. Diefenbaker should not expect the husband's support because she had not had it for 14 years.

—*The Printed Word*, July 1957.

Accounting for Mine Production

GEORGE F. KILNER

BY THE TIME the decision to proceed with the development of the mine has been reached, the engineers and their crews have spent hundreds of hours in projecting the entire undertaking to its conclusion of efficient production. In the process they have accumulated a wealth of classified and detailed information on every conceivable related subject. Expressed concisely, the target must be set to have the mine development and the plant construction completed and ready for operation simultaneously. This necessitates the constant supply of labour, tools and equipment, and materials exactly as needed. When the property is located close to civilization the problems are greatly diminished, but in present day operations the locale is often remote, and the weather is probably extreme and limits the period of access. As a consequence, not only must commitments be made for long periods in advance but accommodation must be provided to house both personnel and material. It is imperative that the accounting too should be well planned for the future. By cooperating from the outset with the engineers who work right at the property, referring to their fund of information and heeding their recommendations and requests, it is quite possible to develop satisfactory records and a system to produce continual reliable results.

Much has been said from time to time about the inclination of mine accountants to indulge promiscuously in cost distributions, multiple controls, etc. Many professional accountants weep bitter tears in complaint at this, but if there must be a fault, it is better to err on the side of excessive distribution rather than be satisfied with very general classifications likely to produce a hodge-podge of totally unreliable reports. While the auditor can render valuable assistance frequently by questioning the need for an apparently complex system of distribution, he should bear in mind the variety of essential needs that do exist for accounting information and make certain that these are provided for in any proposed changes.

Pre-Operating Development

Pre-operating development represents the cost of creating the working plant in the ground (either an open pit or an underground working). Here the lode-bearing ore is produced for conveyance to the plant constructed on the surface where raw material

will be separated and extracted from the waste rock and processed to the form of a concentrate or a refined metal. In fact all expenditure to date, other than that laid out for capital assets or other definite investments, has been pointed in this direction and so forms a proper part of the cost of the development of the mine. The so-called preciseness of accounting dictates that these costs shall be described as deferred disbursements held over for application against revenue derived from ore taken from the development when production commences.

Such expenditures are reflected as a "deferred charge" in the balance sheet. As the tale unfolds, it will become increasingly apparent that in a practical sense this asset is probably more closely identified with the fixed assets of plant and equipment. Were it not for the fact that no residual value remains to a "hole in the ground" when abandonment and disposal must be contemplated, it is entirely likely that stronger support could be found for its inclusion among the fixed assets.

Further reflection will reveal that accurate accounting during this period depends on the distribution of properly classified labour, equipment and supplies. The estimate of time and financing required to bring the mine into production is primarily the responsibility of the engineers and it is natural for them to resist all "paper work" that might tend to upset either of these factors in their carefully prepared plans. Unfortunately, in altogether too many cases, the accounting staff and the personnel directing the development and construction program erect barriers in defence of their own particular function. Under an ideal relationship the accountant will unite with the engineer from the starting gun, each making an honest effort to understand the problems and needs of the other. Each will lay out his plans in advance to meet the requirements and will keep the other currently informed. When properly approached, the engineer is usually prepared to admit that he does demand up-to-date records of costs in respect of each project under way and will recognize that this is only possible if reliable information is supplied daily by the working crews to the accounting office.

It cannot be emphasized too strongly that it is important to have an adequate staff of timekeepers and warehousemen whose training includes the ability to police each job in process continually so as to ascertain that charges are being applied as they actually occur.

Payroll Procedures

The payroll should be carefully segregated to classify separately the many types of service received, i.e. the mine development crew, various construction workers and craftsmen, service departments such as maintenance and machine shops, power supply, cookery, warehouse, transportation, etc., general surface labour, and administrative staff. In most cases it is both impractical and impossible to make use of automatic time clocks so that the foreman of each crew must be charged with the responsibility of signing the daily time slips of each man under his control. Each time slip should indicate the nature of the work performed and the job involved in addition to the hours spent. It is the duty of the timekeeper to insist that these instructions are

followed to the letter and that the slips are turned in daily. He should also visit the various working places periodically as a checking measure. If these requirements are fulfilled diligently and systematically most major problems of labour distribution can be avoided.

Stores Control and Distribution

Stores control and distribution present a much more difficult problem. There is a seemingly endless variety of supplies, material and equipment to be ordered, received, protectively stored and finally delivered to the project for which their acquisition was originally authorized. In many instances, material must be stored for rather long periods and reserved for a particular purpose without the facility of a warehouse. Since the labour force in the development and construction stage is predominately represented by temporary crews, who are under pressure to complete the project by the target date, there is a great and understandable temptation on their part to circumvent the rules by making unauthorized withdrawals from stores, failing to provide requisitions or to complete fully informative requisitions.

Once again it is necessary to prevail upon the foreman to approve all requests for materials. Likely he will object, but the accountant should seek the aid of the engineer to insist upon strict adherence to the principles. As a precautionary measure it is good practice to have the timekeeper check all dubious charges on his rounds of the property. He should also include in his investigation a selection of apparently acceptable requisitions in order to maintain an effective check and control.

The accountant should guard against making many direct charges in his records in order to short-circuit the stores bookkeeping and thereby reduce the volume of work for his staff. Just as soon as he does this the word leaks out, and everybody with any authority at all leaps on the bandwagon and applies a direct charge to every possible invoice. Soon perpetual inventory cards are in utter chaos, costs have been applied to jobs before the work has been performed. Loud protests come from the engineers, and the purchasing department complains of the failure to keep reliable inventory records for their guidance. In fact, it is sound policy to check major pieces of equipment through the stores cards to avoid any violation of rules. As development and construction progresses, adequate warehousing should be provided among the first buildings so that the nightmare of physical control of material and supplies is diminished if not eliminated.

Construction Program

The construction program is a major part of the project and demands a proportionate amount of attention and planning from the accountant. A wide assortment of buildings ranging from warehouses, work shops, administrative offices, dwellings, cookery and power house, to the principal structure of all, the mill, will be scheduled for erection and equipment, together with many special installations such as ore storage bins, fuel tanks and docks. Some buildings will be of a temporary nature to be replaced ultimately by the permanent asset. If possible, these should be carefully earmarked from the beginning to assure correct write-off when dismantled or abandoned. The construction may be carried on entirely

by the company's own labourers but it is more probable that many specialized features, such as steel erection, power house and mill equipment installation, and the placement of roof and siding, will be performed by contractors.

Since the program will undoubtedly be extended over a lengthy period, there is general support for the current accumulation and control of costs via work orders on which the day by day costs are gathered in detail, and transfer is made to the ultimate accounting record as each project is completed. When dealing with a job involving numerous segments, such as the mill, separate work orders should be authorized to cover each individual phase, i.e. excavations, foundations, steel erection, concrete flooring, roof and siding, etc. This reduces the element of accounting error and provides reliable analyses for insurance purposes.

Other Aspects

One of the popular attacks against accounting control during the development and construction stage is the statement that fine distribution is not necessary because the charge ultimately becomes an asset of one kind or the other, i.e., either a fixed asset subject to depreciation or a part of the deferred development amortized at exactly the same time and probably at the same rate of write-off. In theory this may sound satisfactory, but unless reasonably accurate distinction is made the forthcoming results of costs of operation, once production commences, must necessarily be out of line with little hope of making any dependable adjustment. Most engineers are happy to recognize this defence and cooperate from the beginning.

In considering the question of depreciation of fixed assets during the preoperating period, some authorities dispense with the problem by insisting that depreciation is an improper charge until commercial production has been attained and will countenance related charges to the deferred development only as assets are abandoned or otherwise disposed of. Generally speaking, this is acceptable procedure, but special consideration should be given to automotive equipment or other similar fast-wasting assets.

Under present income tax legislation production does not take place until regular milling of ore in commercial quantity (stated to be at 65% of rated mill capacity) occurs. The operations prior to that time, formerly described as the tune-up period, now form a part of the pre-operating development stage. It follows that all revenues derived from the sale of ore, concentrate or refined metal serve to reduce the cost of the preoperating development carried forward for application against commercial production.

Production

With the commencement of production in commercial quantities the entire personnel of the mine settles down to something approaching normal activity. The pattern has been established for all functions of the enterprise, a more permanent work force is engaged in its performance, and although new problems arise, more time is available for their solution.

Certain changes in outlook are required with reference to development which continues with production. Heretofore all such costs have been deferred but with the mine in

operation only those expenditures relating to future revenues should be so treated. The regulations of federal income tax are rather realistic in this regard. They stipulate that main haulageways (drifts and crosscuts) and shaft sinking, including stations and loading pockets, may be deferred for tax purposes. All other development costs, which cover raises (a passageway driven from a main level up to an ore body) and stopes (the working area created adjacent to the ore body and by the removal of the ore itself), are quite truthfully incurred in the immediate act of mining the ore and consequently represent proper charges against current revenue.

The basis of writing off (amortizing) the deferred development is a more absorbing problem. Here again the engineers can offer valuable assistance. Many factors must be taken into consideration, but it is fundamentally sound practice to compute the annual charge as the same proportion of the total cost that the tons milled during the current accounting period bear to the total tonnage of proven ore reserves. Quite frequently this type of calculation becomes complex and even impossible if the engineering information has not been projected very far, but in such cases it is a reasonable indication that mining will run a long course. Under these circumstances it will be necessary to adopt some other basis that is acceptable.

If it is impossible to provide for depreciation of capital assets on the tonnage ratio referred to above, many mines turn to the engineering computations of life expectancy of the individual assets, which normally take conservative salvage value into account if applicable and from these employ a straight-line method. There are many pieces of equipment at a mine that have components subject to abnormal wear, such as the hoisting ropes and liners for the ball mills. These will require replacement many times during the lifetime of the principal asset. In order to avoid undue fluctuation of costs it is customary to make special provision for these items by regular monthly charges to operations supplementing the provision for depreciation.

Some may wonder why mining companies rarely, if ever, write down the cost of their properties even though depletion most definitely occurs with every ton of ore removed. There seems to be no real defence for the practice other than the fact that it has been accepted policy in Canada and it is often impossible to determine the extent of loss in value, if there is any diminution at all. Having regard to the attitude of the federal income tax authorities, as well as the three year exemption from corporate income tax, it is recognized generally that with every dollar returned a specific portion remains free from tax, representing the return of original investment as depletion continues.

Except under very unusual circumstances, no account is taken of work-in-process inventory. It would be impossible to determine the quantities or the point at which the product should be considered and, upon cessation of operating, costs will still be incurred to process the ore to the point of sale.

This is the second of two articles by G. F. Kilner, F.C.A. on mine accounting. The first appeared in the July issue.

Edited by LAWRENCE G. MACPHERSON, F.C.A.

Accounting Research

Director of Research, C.I.C.A.

Confirmation of Receivables

The C.I.C.A. research department has conducted a sample survey of the opinions and practices of members of the Institute with respect to direct confirmation of receivables and inventory procedures.

This note summarizes the survey results as to the confirmation of receivables. (Inventory procedures will be reported upon in a later issue.)

Questionnaires were sent to 200 chartered accountants in practice across Canada, the distribution being roughly related to the number of members in each of the Provincial Institutes. The response was excellent, with 152 replies received.

For the sake of simplicity in tabulating the answers, the questionnaire was designed to take only check-mark replies. It was recognized, of course, that this method could produce only a broad view of opinions and practice, since space was not provided for conditional replies or explanatory comments. Even within these limitations the replies proved to be very informative.

The highlight of the results of the whole survey was the general agreement as to the importance or value of direct confirmation of at least some of the receivables, where receivables are significant in audits leading to the expression of an unqualified opinion. Out of 152 replies, 125 indicated that direct confirmation procedures should be standard practice in such circumstances. The extent of agreement, namely 82%, is evidence of the great change that has taken place in auditing procedures in the past 20 years, and especially since the formal adoption, in 1939, of receivables confirmation and inventory observation as standard practice by the members of the American Institute of Accountants (now the American Institute of Certified Public Accountants).

The participants in our survey were asked to express a preference for confirmation of all receivables or confirmation of at least a sample. Of the 125 who clearly favoured confirmation of receivables as standard practice, 89 preferred confirmation of "at least a sample" either by "positive" or "negative" procedures, and 36 favoured confirmation of all receivables. The preference in choice would no doubt be influenced in many cases by the type of engagement under consideration.

An attempt was made to learn whether auditors considered that the adequacy or weakness of the internal control should have any bearing on the decision to circularize the accounts receivable. Only 27 of the replies proposed that confirmation should be standard practice "only when internal control is inadequate".

Turning from the opinions to the actual practices of the participants, a total of 121 reported that they "always" or "generally" confirm at least a sample. Thirty reported that generally they do not confirm receivables, but 29 of these occasionally confirm

all or a sample. One respondent did not indicate his current practice.

As to the type of direct confirmation used in actual practice, 29 firms reported that they always use the negative type, and 87 that they generally use the negative type, when they confirm receivables. This makes a total of 116 out of 152, or 76%, whose usual practice is to call for a reply only if the debtor disagrees with the client's claim.

Twenty-seven firms reported that, when they confirm receivables, their practice is to use a combination of some positive and some negative confirmations. The value of the combined procedure in some circumstances is suggested further by the fact that it is used occasionally by 54 firms, making a total of 81 who combine the two types in at least some of their audits. Comments volunteered by respondents indicated a variety of circumstances when this procedure is found to be suitable, for example, when there are many small accounts and some large accounts, or when regulations require positive confirmation of certain types of accounts as in some audits of brokerage houses.

The survey did not attempt to cover all aspects of the procedures involved in direct confirmation. Many problems have to be faced in practice, such as timing and frequency of confirmations, size of sample to be used, degree to which unanswered original requests should be followed up, difficulties or practical impossibility faced by some debtors in attempting to comply with the requests, and use of alternative procedures where necessary.

Several of these questions will have a bearing on the ultimate decision of the Committee on Accounting and Auditing Research in regard to the issuing of a bulletin on the subject. The committee is now examining the need for a bulletin which might recognize direct confirmation of receivables as a standard auditing procedure in appropriate circumstances. No doubt the bulletin would include a section on other procedures in lieu of direct confirmation. The committee would like to receive reports of experience or expressions of opinion on this subject from members of the Institute.

THE EXAMINATION OF DUPLICATE DEPOSIT SLIPS

By Gertrude Mulcahy, C.A.

The C.I.C.A. Research Committee has recently been giving consideration to auditing procedures relating to the examination of duplicate deposit slips. Discussions on this subject were divided into two areas:

1. Comparison of details of duplicate deposit slips with record of cash receipts.
2. Comparison of duplicate deposit slips with originals on file at the bank.

While it is recognized that no specific rules can be laid down which will necessarily apply in every case, authoritative auditing texts seem to indicate variations in the general procedures of both areas. In order to obtain some indication of current practices, the committee requested 12 accounting firms across Canada to outline their policies with respect to the comparison of duplicate deposit slips with records of cash receipts and

with original slips on file at the bank. Of the firms approached, 11 provided the information requested. It was apparent that, within this group, the former procedure is normal practice while the latter is carried out only under unusual circumstances.

Comparison with Cash Receipts Record

In "Auditing Procedures — An Introduction for the Student-in-Accounts", H. C. Dell and J. R. M. Wilson point out that a comparison of the details of duplicate deposit slips with record of cash receipts forms part of the auditing procedures used by public accountants in cash counts, checking of bank reconciliations and test checking of accounting records. The operations to be followed in the counting of general cash include "Check duplicate deposit slips in detail against the cash book for several days preceding the date of the count" and "Trace outstanding deposits to the bank statement and check the relative duplicate deposit slips in detail against the cash book and cash count". When checking bank reconciliations, Messrs. Dell and Wilson state, "The duplicate deposit slips covering the outstanding deposits should also be checked in detail against the cash book." Such verification procedures "should also be extended to reconciliations made at times other than the balance sheet date if the outstanding items appear in any way out of the ordinary". In connection with the accounting records, it is explained, it is usual to carry out this type of comparison at other times during the year as well as at the date bank reconciliations are checked.

Ten of the firms replying to the committee's request indicated that this comparison normally formed part of their standard current audit program to be applied to the period during the year selected for detailed examination, while one firm made no specific comment. In practically every case, it was noted that the comparison was carried out on a test basis. In addition to the above information, 3 firms indicated that it was also carried out with respect to the period immediately preceding a cash count, 2 firms made specific mention of using it in connection with the verification of outstanding deposits, and one noted that it was also followed for a few days prior to the circularization of accounts receivable.

In some instances, because of the nature of a client's receipts, the comparison of the duplicate deposit slips with cash receipts records is not possible and would be meaningless. A dairy company whose collections are almost entirely in currency and a newspaper company whose receipts tend to be in even round amounts representing periodic subscriptions were noted by one firm as cases in which a comparison of this sort would be ineffective. However, in the opinion of one of the firms, the fact that sometimes "the test is not capable of being carried out does not alter the fact that where it is possible, it should be done".

Because the banks today generally do not attempt to relate the deposit in detail with the particulars shown on the deposit slip, but certify as to total only, the comparison of the duplicate slips with the cash receipts records does not provide conclusive evidence of the accuracy of the accounts. In spite of this, it was generally agreed by the committee and by the survey firms that, on a test

basis, this was a desirable procedure if for nothing else than to see what is happening. In support of this opinion, one firm commented:

"While there are many unsatisfactory features to duplicate deposit slips considered as documentary evidence, we believe it is wrong to ignore them entirely. If the auditor concentrates all his attention on a few obvious types of documents such as cancelled cheques and invoices, he will tend to develop a stereotyped program. There are many documents of subsidiary importance from an audit viewpoint (such as receiving slips, customs entries, order forms, etc.) which are nevertheless useful as supporting evidence. We would classify duplicate deposit slips with these documents of secondary importance."

Comparison with Originals on File at the Bank

While auditing texts agree that the comparison of duplicate deposit slips with the originals is a desirable procedure in circumstances where the internal control is weak, or where there are other reasons for an extended examination, there appears to be some difference in the approaches suggested. Smails' "Auditing", 4th ed., suggests that the original deposit slips should be obtained from the bank, whereas Montgomery's "Auditing", 7th ed., refers to duplicate slips prepared on request by the bank from the original in their files.

Only 2 of the 11 firms indicated that this type of comparison was carried out to any great extent, and both reported that it was tied in with the testing of the details in the cash receipts book. As to the actual approach, one of the firms stated:

"This is done on a basis calculated to cause the minimum of inconvenience to the bank. In some cases, we ask the bank to supply copies which they do and sometimes charge for. In other cases, we take the duplicate deposit slip to the bank and compare it with the original which has been drawn from the files by request."

The other firm reported:

"These deposit slips are then taken to the bank and compared there in detail with the originals on file at the bank. The bank is asked ahead of time to get these out for our inspection."

Of the remaining 9 firms, one indicated that it was not their policy to compare the duplicate deposit slips with the originals on file at the bank, or to request the bank to prepare for the firm's use a copy of the original slips on its file. Eight replied that this type of comparison was carried out only occasionally in special circumstances, such as when specifically requested by the auditors of an American parent company, or when other audit procedures have cast doubt on the reliability of the duplicate deposit slips, or where there is suspicion of fraud. None of this latter group outlined how this comparison was made, but several offered interesting comments as to why this procedure was not part of their regular audit program. One firm noted, "This is an onerous and time-consuming test which is not justified in ordinary circumstances by the results that are likely to come from it." Another commented, "In general, we feel that the attitude of the banks in not accepting any responsibility for the details shown on a deposit slip makes this procedure of limited value as a regular auditing requirement."

Another firm pointed out:

"Under modern banking practice the deposits are apparently not checked in detail on receipt except possibly at the smaller branches. Knowing this, a potential defaulter would see that the original and duplicate deposit slips did agree, risking the possibility that any difference with the actual items in the deposit is observed by the bank teller."

Agreeing that, because of the changes in bank practice, a check of the duplicate slips against the originals is not conclusive evidence, one firm stated further:

"There is also a question as to whether one of the objectives of an audit is to uncover employees' frauds. In at least some of our larger clients it would be recognized that the prevention and detection of fraud is primarily the concern of management through its internal control procedures. For these reasons, the tendency has been over the years for us to reduce the amount of checking of deposit slips."

In contrast, one practitioner reported as follows:

"My own personal view is that the comparison of duplicate with original should be part of a standard audit program, and, as a result of receiving your letter and my subsequent inquiry into our own methods, I am satisfied that in due course the procedure will be added to our standard program.

"From my own experience, I am not persuaded that changes in banking practice in recent years entirely destroy the usefulness of the comparison between duplicate and original. It is true that in many of the larger branches the teller may not check off each cheque listed in the deposit slip, but the one thing that he does check is the division of the total deposit as between cash and cheques. I have found that, in the case of several defalcations which have been discovered largely as a result of comparing duplicate deposit slips with originals at the bank, invariably the amount of cash shown on the duplicate differs from the amount shown on the original. This is part of the pattern of this type of defalcation, i.e. a substitution of cheques for cash which has been abstracted, and the discovery of this fact is the important result of the comparison of duplicate with original."

Suggested Plan

A partner of one of the survey firms submitted the following plan whereby he felt the usefulness of duplicate deposit slips would be greatly increased from an audit point of view:

"The plan is that any company, which wished to do so, could prepare a duplicate deposit slip (say on a specially tinted form) each time it made a deposit. This duplicate would be collected by the teller and would be returned to the company along with the bank statement and cancelled cheques.

"In the proper control of cash, the separation of functions is clearly of basic importance. It should be part of every system that cancelled cheques and bank statements are sent by the bank to a responsible officer of the company who is not primarily responsible for custody and depositing of cash. It is only thus that proper test reconciliations are feasible. It would greatly improve the possibility of control if duplicate deposit slips came back in the same manner.

"I cannot imagine why this would present any serious problems to the bank. Morover, if this system were introduced, the banks could get rid of the present practice of some auditors who demand access to the original deposit slips — a very onerous requirement for the banks. From the point of view of the auditors and of the companies, the procedure would have the following advantages:

1. The duplicate deposit slip would be returned by the bank to the responsible officer who gets the cancelled cheques, and would not simply be returned to the employee making the deposit.
2. It would be impossible to alter the detail on a deposit slip after it came back from the bank, at least until the senior officer receiving the slip had had an opportunity to check it to the records.
3. It would be much more dangerous to present the bank with a duplicate deposit slip that did not agree in detail with the original, than it would under present conditions. At present the teller is extremely unlikely to even glance at the details on the duplicate. However, if the duplicate was in possession of the bank for a considerable period of time, any dishonest person would be running serious risks in attempting to submit a duplicate that did not agree with the original in detail."

* * *

This suggestion appears to have a great deal of merit, and the Committee on Accounting and Auditing Research invites comments from the members of the profession on it.

BY KENNETH M. PLACE, C.A.

Administrative Accounting

Internal and External Statements

Today many companies publish some form of financial statement more frequently than once a year, chiefly to inform the public of the state of the enterprise. Almost without exception, however, every commercial enterprise prepares financial and operating statements for its own use at least quarterly and in most cases on a monthly basis. The difference in purpose and preparation of these latter statements is significant.

The major purpose of internal statements is to assist management to operate in the manner best calculated to maximize profits. While published statements reflect the results of operations for a stated period and the actual assets and ownership of them at the end of that period, internal operating statements are designed to provide the maximum amount of information about the various operations of the business during the period, with a view to reflecting the progress made when related to a predetermined plan of operations. In addition, they show a detailed statement of the investment used in the business.

The difference in purpose must be borne in mind when designing the format and the necessary procedures to obtain the required data. Statements for internal use are more detailed and complicated and should therefore be examined to see if the information required for external statements can be obtained as a by-product from them.

The first point to establish is what controls will be most useful to management.

Most businesses today set themselves predetermined goals, usually in the form of a forecast or operating budget, and their first aim is to determine how successful they have been in terms of the plan. To accomplish this, their internal statements must be prepared in the same manner as the master plan. Inconsistencies will not only defeat the purpose, but may even lead to unwarranted complacency and the omission of corrective action.

A going concern sets up its own momentum. It is not as interested in knowing how much profit or loss it has to date, although this is important, as in knowing whether it will continue to show a larger or smaller net loss or gain. This momentum means that things done now will produce events tomorrow. The basic objective of the forecast then is to link the present with the future to show the direction of travelling and the probable destination. Thus a principal difference between internal and external financial statements lies in the areas of quantity of information and timing. The information desired by management is statistical rather than financial and must be gathered and presented in usable form quickly. Management needs re-

ports that relate yesterday's actuals to today's probabilities and tomorrow's possibilities. The approach must be more than just accounting; it must encompass an intimate knowledge far beyond the simple gathering and summarizing of recorded information in a conventional form.

In all but the smallest of enterprises, today's manager usually has reports prepared which give a variety of information not normally conveyed by the profit and loss statement and the balance sheet. The latter are the final summarization of the bookkeeping process, whereas the former may range from a daily record of sales to the most elaborate tabulations of expenses by departments. The one common thread, however, is that both usually relate to accounting figures.

This leads to another problem. Figures derived from the bookkeeping process are usually presented as subsidiaries of the two fundamental financial statements and are required to "tie in" with them to ensure their mechanical accuracy. But management demands timeliness and speed of preparation. This conflict between the requirements for accuracy in accounting and the desire for current information on the part of management necessitates a reconciliation between the two needs.

The first step towards reconciliation is to know what reports are being prepared. Profit and loss statements and balance sheets are of course the keystone, but care must be taken that all other reports are not tainted by the emphasis on accuracy in preparing these two.

All reports should be classified according to who prepares and who receives them and a number of points should be kept in mind. Are they correct? How much work is involved in their preparation? What do they tell? Do they compare prior periods with the current one? Do they compare current results with the forecast for the period? Are they properly related to each other, and how much duplication of effort is involved in presenting essentially the same information in slightly different form? Are they based on proper measurement of the facts? Honest answers to all these questions will reveal a surprising degree of overlapping and a number of irrelevant and useless reports.

Looking at the recipient's side, the first question is: what use is the report? Is it anxiously awaited, missed if not received? Or is it merely interesting information?

At this point, the accountant must project himself into the position of management and realize that it is engaged in directing others and issuing instructions for things to be done. For this reason, the reports it receives must highlight the important things, the matters that need corrective action, the danger signals, the areas that need further examination. Herein lies the fundamental concept of industrial or management accounting. Although accounting is considered an exact science, it is in reality an exact science based on judgment. Within any fiscal period, much of the basic accounting information is the result of informed guesswork, estimates of inventory value, merchandise returns, bad debt losses, depreciation, and many other items of income or cost. Monthly operating statements have been known to require sharp adjustments for any one of a number of causes.

Internal reports, then, must point the way; they need not be 100% ac-

curate. The manager is interested in the direction and momentum of his business, not the exact distance which it has travelled. And since his business is continually changing, he cannot wait for a theoretically correct estimate of its condition. He does need a statement of conditions which permit him to check his position and take any corrective action which may be necessary.

A good industrial accountant has to provide management with meaningful, timely information and maintain the accounting records necessary for corporate financial reporting. He also has the overriding responsibility for establishing control procedures which will permit proper safeguarding of the company's assets. His most significant function is undoubtedly the first. The other two are largely mechanical and relate almost entirely to the bookkeeping aspect of the job. To reach the maximum degree of usefulness, the accountant must rise above the limitations of strict accounting theory or any preconceived practice of accounting. He must be able to adapt himself and his thinking towards the needs of management.

To sum up: published statements are designed to provide information regarding past results for a specific period and investment and ownership at a point of time. Internal statements should tell management sound, accurate and timely information on which to base its actions and decisions. It has been found that if the needs of management are fully met, all the information required for the more formal historical published statements will be readily available. Proper preparation of internal statements automatically ensures fulfilment of the requirements for corporate statements.

BY A. WILLARD HAMILTON, C.A.

Tax Review

Capital Gains

One of the areas of greatest difficulty in income tax practice lies in the determination of a capital gain, which may arise from the realization of the appreciation in an investment or by way of a fortuitous or casual gain made by a taxpayer in such circumstances that it cannot be held he was engaged in a trade or business, or "an adventure in the nature of trade". This subject has been considered in this magazine at frequent intervals and the general principles are well stated in the January 1957 Tax Review by Mr. Melville Pierce under the title "Isolated Commercial Ventures".

However, if the number of cases currently being heard by the Appeal Board and the Exchequer Court is any indication, the problem is one of continuing difficulty, even though the number of cases decided against the taxpayer appears to be greatly in the majority. It is believed that a resumé of a few of the cases might provide some assistance to readers in the consideration of marginal cases. Certain cases, which have been decided in favour of the taxpayer, will be discussed in the current review, and the commentary in a later issue may be directed to a discussion of other decisions unfavourable to the taxpayer. Basically the same features —or the absence of them — which have influenced the courts in deciding in favour of the taxpayer provide the grounds for the decision against the taxpayer in other circumstances. However, as more and more cases are heard the uncertainties should tend to diminish and thus a clearer pattern emerge. The application of the principles reiterated in recent judgments should be a helpful step in the right direction.

Profit on Second Mortgages

(*Arthur Cohen*, Ex. Ct., June 3, 1957)

One of the recent judgments of the Exchequer Court of Canada deals with the question of a possible tax liability on profits realized during the years 1949 to 1952 inclusive, on certain mortgages purchased at a discount. The appellant, Cohen, acting on the advice of his solicitor, a friend, purchased about 16 mortgages which were paid in full either before or at maturity during the four years in question. The profit, i.e. discount on such mortgages, aggregated some $46,500, and it was this profit which the Minister attempted to assess on the grounds that the taxpayer was in the business of lending money and purchasing mortgages at a profit.

It was established that all mortgages purchased by the taxpayer bore interest at the current and normal rate for such mortgages, which interest was duly reported in his tax returns. It was also shown that there was a substantial element of risk in all the mortgages purchased at a discount and that lending corporations would not be interested in acquiring them.

It appears that Mr. Cohen relied to a very great extent on the advice of his solicitor: he did not advertise that he had money to loan, he knew none of the parties to the mortgages and, except on one or two occasions when he drove with his solicitor to see the property, had no personal knowledge of the security. The main submission of counsel for the Minister of National Revenue was that the profits stemmed from "an adventure or concern in the nature of trade", or alternatively that they were profits from "property" or "from a source". The court was unable to find that the appellant so "organized himself" (to buy mortgages at a discount) in a commercial or mercantile way, or that the capital accretions represented gains made in an operation of business in carrying out a scheme for profit-making. If either element of (a) organization in a commercial way or (b) an operation of business were present, the gains would have been taxable for it is a part of such a business to take capital risks. The court was not of the opinion that the taxpayer's primary purpose was to secure the discounts but rather that the discounts realized were not of such a nature as to be considered as additional interest or as taxable profits, but rather as a gain made by an enhancement in value upon realizing a security.

In the opinion of the court, the profits realized by the appellant could not be distinguished from those made by another investor, who, instead of purchasing mortgages at a discount, purchased a number of bonds or debentures in various companies at a discount.

It may be interesting to note that the judgment of the Exchequer Court reversed the decision of the Appeal Board in this matter, where it had been found that "when the appellant began purchasing mortgages at a discount, he entered into a scheme for profit-making".

Sale of Timber-Land

C. W. Logging Co. Ltd., Ex. Ct., Jan. 13, 1956)

In another Exchequer Court case, it was decided that a capital gain had resulted upon the sale of a block of timber-land which had previously been logged.

Actually, there were two points at issue and the questions to be decided were (a) whether the proceeds of a sale of the standing merchantable timber in 1950 and (2) the sale in 1952 of the freehold land constituted income from a business or from a property. The profit of the sale of the timber limits in 1950 was considered to be part of the normal business of the company, because any timber limits bought were purchased with a view to realizing profits from logging them, and the sale of limits with a certain amount of the merchantable timber was not considered to be different from the ordinary course of business of the taxpayer. However, at no time did the company engage in the business of buying timber limits with a view to selling them at a profit.

One of the interesting points in this decision relates to the tests to be applied to transactions of the nature stated to determine their taxability. These were mentioned as being—

(a) intention
(b) course of conduct, and
(c) the nature of the objects set out in the charter of the company.

The observation of the court with respect to the powers contained in the

letters patent is particularly interesting, as the opinion was expressed that charter powers are not absolute in the determination of an income tax position. The court said, "I am concerned more with what business or businesses the appellant, from a realistic and practical standpoint, actually did carry on or engage in rather than with what business or businesses it, under the terms of its memorandum of association, has authorization to carry on or engage in. Objects and powers included in the charter of a company often go far beyond actual and practical requirements."

The court held, therefore, that the 1950 profit on the sale of standing timber was properly taxed but that the sale of the timber-land in 1952 was the sale of a capital asset and that the proceeds of such sale were not revenue received from the conduct of a trade or business and so did not constitute taxable income.

Sale of Timber Limits

(*No. 370,* ITAB, Nov. 14, 1956)

In 1948, through his connection with the forestry industry as a consulting engineer in his brother's logging business, the appellant was offered an attractive timber limit largely comprising young trees which he thought might make a suitable long-term investment. The purchase was arranged for $6,000 and the brothers arranged privately that the appellant would own two-thirds and his brother one-third of the limits.

For lack of capital the brothers had to defer the selective cutting of the wood contained in the limits which they had hoped and intended to do in the five years following the time of purchase. In 1952, an opportunity was afforded the brothers to enter into aerial photography work in a certain area in the province where they lived.

They first entrusted the work to a company which specialized in such matters but found late in 1952 that the work had not yet begun. As a result, the appellant and his brother formed their own aerial photography company, the capital requirements of which were placed at some $200,000. The brothers did not have sufficient resources, but a previous inventory of the timber limit by aerial photographs had indicated a possible fair value of $220,000 for the limits. A plan was arranged therefore of forming a company which would acquire the limits for $220,000, and this would enable them to obtain at least a portion of the credit required to put the aerial company into operation.

The Crown attempted to show that through subsequent action by the timber company an exchange was made with the provincial government for cutting rights to be operated immediately, and by inference the intention was to carry on business.

The court gave a lengthy review of pertinent cases to show that a corporation and its shareholders were separate and distinct and concluded that the action of the corporation could not be persuasive of the intention of the appellant at the time that he acquired the limits. The taxpayer's conduct was that of an investor who acquired property in the hope of making it prosper, but because of circumstances beyond his control had to dispose of it. The profit was held to be a capital gain.

Consideration for Termination of Partnership Agreement

(*No. 379,* ITAB, Jan. 7, 1957)

Three "associates", the taxpayer,

his father and a brother, made an agreement in 1954 with a partnership, consisting of eleven Egyptians, for the purpose of developing a housing project. The associates were to organize and carry on the building operations and the partners were to provide financial assistance. Because of differences in nationality, temperament and outlook, disagreements soon developed between the two sets of parties, and eventually it was arranged that the associates would sell to the partners all of the shares of the associates in the capital stock of "M" Homes Limited (the land company) and all of their shares of "M-C" Builders Inc. (the construction company). In addition, an amount of $32,500 was paid to the associates in consideration of the termination of the partnership arrangement and in full settlement of any claims of the associates against the various companies and/or the partnership. The appellant, one of the associates, was assessed for his one-third interest in the $32,500, or on an amount of $10,833.33, on the basis that the amount constituted a retiring allowance.

The Income Tax Appeal Board found that there was no master and servant relationship and that the amount was not a "retiring allowance" but was paid to the associates to free the partners from what to them had become an onerous obligation and to obtain any release of claims against them through the execution of the agreements referred to. The payment was held to be a capital sum and the assessment set aside.

Sale of One-Sixth Interest in Syndicate

(*No. 408*, ITAB, Feb. 7, 1957)

In February 1951, the appellant, a practising solicitor, entered into an agreement with certain clients to form a partnership or syndicate for the purpose of buying land and erecting houses in the metropolitan area of Toronto. The syndicate's capital was some $35,000, of which the appellant held a one-third interest, amounting to $11,666.66. It was agreed that profits and losses were to be divided according to paid-up capital. The solicitor was to collect normal legal fees for services rendered.

In 1951, the appellant sold one-half of his one-third interest in the syndicate for $15,000 and the Department of National Revenue assessed the profit as being taxable income. At the time of the sale of the one-sixth interest in the venture, there had been no sale of lots or houses in the development. The court observed that the position of the purchaser, a certain Mrs. B.B., was that she received for her $15,000 no specified portion of land, or any part of the parcel of land acquired by the syndicate, but rather a one-sixth interest in the syndicate. In 1952, however, profits derived from the syndicate venture were distributed to the partners in proportion to their respective interests and the appellant reported his one-sixth share in the usual way.

The court accepted the view that the appellant sold one-half of his interest in the paid-up capital of the syndicate and that the resulting profit was of a capital nature.

Employee Housing

(*George L. Bower*, ITAB, Sept. 14, 1956)

Since 1940, G. L. Bower had been engaged in excavating and heavy hauling operations of a considerable size in the City of Regina. Finding that his employees were having much difficulty in obtaining housing accom-

modation, owing to the shortage of housing which existed at the time, and to retain key employees who were being enticed away by other employers of labour, he decided on a policy of obtaining suitable housing accommodation for such key employees. This policy, he stated at the hearing, had shown very good results.

Certain lots were purchased at different locations around the City of Regina and he had a friend look after the erection of a number of houses which he purchased. Three of these houses were sold in the years 1952 and 1953 and the Minister assessed the profits thereon as being taxable. It was determined by the Income Tax Appeal Board that he was not in the business of buying and selling real estate, that the sale of the three houses in question arose out of varying circumstances which were satisfactorily explained at the hearing and the said profits did not arise from anything in the nature of an adventure in trade, but arose out of fortuitous circumstances and should be treated as capital gains.

Sale of Farm

(*John Lloyd McGuire,* Ex. Ct., March 29, 1956)

In 1940, J. L. McGuire purchased a farm outside the City of Hamilton and lived there with his wife and family for some years. Because of financial difficulties he was not too successful in operating the farm and, when he received an offer of purchase, decided to sell a lot on the upper part of his farm.

However, because of the requirements of the Planning Act, it was necessary for him to file a plan of subdivision of the land before a sale could be consummated. It appears that the plan of subdivision comprised 54 lots, of which some 20 lots were sold during the years 1949 to 1953 inclusive. The Minister claimed that a scheme of profit-making had been embarked upon.

Dealing with the question of intention, the court held the opinion that McGuire had no intention in 1940, when he purchased the property, of ultimately selling it under a plan of subdivision. It was noted that he and his family continued to live on a portion of the property. If the land was not purchased as a venture or for speculation, the court did not consider that he would be liable for income tax on any profit made and could see no distinction "between selling the land as a whole or selling one-half of it or selling one-quarter of it or selling fifty parts of it". The profit was held to be a capital gain and not subject to taxation.

Real Estate

(*Leslie Todd,* ITAB, May 2, 1956)

Two brothers, employed by their father in the contracting business, had accumulated sufficient funds in a joint bank account to purchase for $6,000, in 1951, an estate property of 19½ acres, which was being offered for sale. The funds utilized by the brothers for the purchase were previously in a joint bank account in the Royal Bank of Canada, which was a current account and earned no interest. This they did without reference to their father, who was away on a trip to Europe. The evidence indicated that neither the father nor the sons had ever bought or sold land or built houses prior to 1951. The intention of the brothers, one of whom was a minor, when purchasing the land, was indefinite, the purchase being

completed because of the recommendation of a friend who thought that "it would be a good place to put their money". The land remained more or less idle for some time in that they neither improved it, had it subdivided, nor offered it for sale. In 1954, an offer of $40,000 was received for the property from Citadel Development. Later in 1954, an offer of $50,000 was received and this offer was eventually accepted by the brothers.

Mr. Fisher of the Appeal Board stated that "when a property is purchased or when an investment is made, there is always the intention, or at any rate the hope, that eventually the funds put into the property or the investment will appreciate in value so that the investment may be disposed of at some future time at a profit".

It was noted that intention is only one of the several factors which have to be taken into consideration and, in the subject case, it was felt that the other factors to be considered such as the number and frequency of transactions, the relationship of the particular venture to the taxpayer's regular business, etc., were in favour of the taxpayer.

Mr. Fisher also said, "While the receipt of an annual income from property or from investment is one of the criteria to be considered in such matters, I cannot agree that, merely because a property of any nature is purchased and is non-revenue-producing, therefore, ipso facto, it must be presumed when the property is sold that the purchaser had the ultimate intention of selling it at a profit by entering into an adventure in the nature of trade which would automatically result in any profit realized from such a sale being liable to income tax." The gain was held to be a capital gain.

Real Estate

(*No. 290,* ITAB, Oct. 17, 1955)

A building contractor, who between 1946 and 1951 built houses located mainly in the north part of the city in which he lived, felt that as there were no stores in that locality, it might be profitable for him to invest money in building stores which he would rent. A plan was prepared for ten small and two large stores to comprise a shopping centre and the appellant's architect met with the city authorities to discuss the purchase of the twenty lots required to carry out the plan. Difficulty was encountered in that he could only purchase 148 lots, including the desired group of 20 lots.

To make the required payment of $52,500, the appellant took some $20,000 or $25,000 from his contracting business out of advances made to him by his bank for that purpose. The appellant was then advised by the bank manager that they could not permit their advances to be used for the purchase of vacant land and that he would have to take the necessary steps to rectify the matter. Consequently, the appellant, during the year 1951, sold 31 lots to recover part of the capital investment without which he could not have carried on his construction business.

The Minister assessed the land profits on the grounds that it was part of the normal business of the taxpayer to buy lots and that the appellant had engaged in an activity in the nature of trade. It was found, in the light of all circumstances, that his conduct was not that of a person who

engaged in an activity in the nature of trade, and his appeal was allowed.

Real Estate

(*Albert Martin*, Ex. Ct., Feb. 20, 1957)

In 1946, a Montreal parish wished to purchase a certain parcel of land being sold at an auction, and, in the hope that a lower price might be obtained by an individual if the parish did not appear as a principal, one Albert Martin, a church warden, was nominated to buy the land personally and to resell it to the parish at the same price. The purchase having been made, the parish refused to repurchase the land from Martin and in order to recover his investment, the land was subdivided into building lots, some houses constructed thereon, and from 1947 to 1950 several of the lots and houses were sold.

The Minister attempted to assess the profit as being income from the business. However, following the reasoning in the *McGuire* case (see above), it was held that the profit was a capital profit on the grounds that, where the intention of the taxpayer, in acquiring land, is obviously not speculative, the disposal of it, in parcels, is not in itself sufficient to make the profit subject to tax. The construction of houses on the lots might be considered as somewhat unusual and possibly damaging to the taxpayer's case, but the whole transaction was viewed together in the light of the general course of conduct of the taxpayer. The profit from the real estate transactions was held not to be a commercial or speculative profit but rather the capital increase from an investment in real estate.

BY PETER C. BRIANT, B.COM., C.A.

Current Reading

The Return on Investment Concept

Since articles illustrating applications of the return on investment (ROI) formula for management purposes appear so frequently in current accounting and financial journals, a brief explanation of the basic concept may be helpful to some readers.

The Assumption

At the root of the concept is the assumption that management is primarily interested in maximizing the return on assets employed. Operating performance, capital investment projects and profit plans are therefore evaluated in this context. Some argue that maximizing return on investment is not a valid criteria when applied to one fiscal period. It is more reasonable to assume, they argue, that maximizing return on investment *over the long run* is the realistic and reasonable management objective. Automobile manufacturers, for example, take pride in the fact that in the years immediately following World War II they did not charge, at the factory, all the market would bear, and hence did not maximize the return on funds committed. Their aim is said to be to earn a steady long run rate of return on average capital employed. But no matter what the time period, return on investment is still an important consideration.

The Formula

Return on investment is calculated by relating net income (either before or after taxes) to the assets employed. Expressing the essential components in the form of an identity results in the formula shown below.

Return on investment is thus a compound of turnover and earnings ratio, with both factors of equal importance. An infinite number of combinations of these two elements will give the same return on investment.

The failure to recognize the equal rank of these two components has led to some fuzzy thinking at times, the "Fair Trade" argument being a case in point. Its proponents argue that manufacturers should establish retail prices and should endeavour to prohibit price cutting by their retail outlets, thereby protecting their retailer's profit margin. But there is little point in protecting profit margins if turnover is materially decreased in consequence. This has happened in the United States, where the turnover of investment of some Fair Trade retailers has suffered severely from discount house competition.

The Investment Base

One of the most difficult problems arising in the application of the ROI concept is the determination of the

FORMULA: $$\text{Return on Investment} \; \frac{(\text{Net income})}{(\text{Investment})} = \frac{\text{Sales}}{\text{Investment}} \times \frac{\text{Net Income}}{\text{Sales}}$$

investment denominator. Should it be gross assets before depreciation or net assets after depreciation, or should replacement cost be used?

A survey recently conducted by the Controllership Foundation, and reported in the June 1957 issue of *The Controller*, reveals that there is no general agreement as to the "preferred base". The choice, it appears, depends on a number of factors, such as the use to be made of the ratio, company organization, volume of operations and the nature of the assets. One respondent, a management consultant, suggests that, in determining the base to be used, consideration should be given to the relation of total current assets to total fixed assets. If fixed assets represent a relatively small part of total investment, he says, the deduction of depreciation would have little effect in the calculations. The choice would then depend, in his opinion, on the use to be made of the ratio: for measuring managerial efficiency, gross assets may well be used; for planning new locations, depreciation should be taken into account and net asset value used in the investment base.

Many of the company controllers participating in the survey think that gross assets provide a more stable base and give a more accurate trend picture for use in making long-term plans. Moreover, they have found that using a net asset base makes a comparison of divisional performance difficult where write-off periods vary from division to division.

One responding company favours a net asset base because it relieves old assets of earning a return on the portion of the original investment recovered and reinvested in other fixed assets or in working capital.

In the same issue of *The Controller*, H. O. Edson discusses (p. 271) the valuation of investment charged to divisional organizations. Net book value is, in his view, entirely unacceptable for this purpose because it can lead to ever increasing rates of return, thus making it impossible to compare divisional operating performance from year to year. Nor would he use replacement values in the investment denominator. The complexities involved in this area, he says, are best left to the "completely theoretical environs of the classroom". In the final analysis, it appears that valuing assets at acquisition or historical cost is the best alternative available for the return on investment computation. Only improvements in productivity are then reflected in the ratios.

The Use of the Formula

For control purposes, it is essential to have in mind some percentage rate that represents a reasonable return on investment, taking into account the risks involved. Some companies use as a standard a 20% return (before income taxes) on average capital employed, or approximately 10% after taxes. If the actual return is, say, 15% before taxes, any one, or more typically any combination, of the following courses of action may be proposed as a means of getting back to the required 20%:

1. Increase sales, holding investment and earnings ratio constant, so that a greater turnover is applied to the same rate of earnings on sales.
2. Hold investment and dollar sales and, therefore, turnover constant, while reducing expenses in order to increase the earnings ratio.
3. Hold dollar sales and earnings ratio constant, but reduce invest-

ment, with the same result as in (1).

It can thus be seen that the return on investment identity provides a convenient way of subjecting every aspect of a company's operations to intensive scrutiny, with one thought in mind: what is the return on investment?

a. *Revenue Adjustments*

Introducing some details into the identity, it is possible to focus attention on some of the significant variables. Sales, for example, are a compound of physical volume and unit price.

If a firm finds its rate of return unsatisfactory, concludes that its investment cannot easily be reduced, and has a relatively inflexible current cost structure, it has to find a way to increase its sales volume so that the same earnings *ratio* may be applied to a greater turnover. Sales volume may conceivably be increased by reducing prices; but competitors may retaliate with price cuts of their own. Price competition is not, therefore, a policy favoured by many firms. The alternative is to induce a greater volume of sales, at current prices, by resorting to non-price competition which, if successful, has the effect of shifting the demand curve for the firm's product to the right. Non-price competition opens up a complicated bag of tricks embracing packaging, branding, advertising and various other promotional schemes that come to the mind of the sales executive.

b. *Expense Adjustments*

Expenses may be classified in any number of ways. One that immediately comes to mind is a break-down of costs by functions, with the identity expressed as shown below.

The reader will see that the conventional manufacturing statement and income statement are subjected to searching analysis with the intention of reducing operating costs in order to increase return on investment.

Many other expense classifications will come to the mind of the thoughtful reader. It is not the purpose of this brief note to explore them all.

c. *Investment Adjustments*

When a firm resorts to policy (3), noted above, the assets side of the balance sheet is studied. The cash float may be reduced, credit policies may be tightened, inventories cut down and, in the long-run, long-term investments in plant and equipment reduced. When we read of an "inventory adjustment" in the economy, it means that, in the face of sales cuts, business firms are reducing their investment in merchandise in order to re-establish their turnover and, hence, maintain their return on investment. Plant and equipment adjustments take longer, giving rise, in part, to what economists refer to as the "con-

$$\text{Return on Investment} = \frac{\text{Sales}}{\text{Investment}} \times \frac{\text{Sales} - (\text{production costs} + \text{selling costs} + \text{administration costs}) - \text{interest charges} - \text{taxes}^{1}}{\text{Sales}}$$

[1] Net income before interest and taxes should be compared with total investment; net income after deducting interest and taxes with owners' investment.

struction cycle". Short term investments in merchandise and long term investments in plant and equipment comprise an important and volatile part of our total economic activity. Some economists argue that changes in these two components are a primary cause of the business cycle. Whether or not they are correct, their reasoning can be followed quite easily from the return on investment formula.

Applications of the return on investment formula will be discussed in next month's issue.

BOOKS RECEIVED

"Principles of Accounting: Introductory" (5th Edition), by Finney and Miller; Prentice Hall, Inc., New York; pp. 757; $9.25.

"Cost Accounting" (2nd Edition) by Schlatter and Schlatter; John Wiley & Sons, Inc., New York; pp. 725; $7.25 [to be reviewed].

SELECTED READING

Accounting

"Merchandise Management Accounting in Practice" by R. I. Jones. *The Arthur Andersen Chronicle,* April 1957, pp. 91-103.

"Improving the Readability of Reports" by C. W. Moonie. *The Arthur Andersen Chronicle,* April 1957, pp. 104-107.

"The Accountant and Inflation: Changing Price Levels" by J. R. Leitch. *The Accountants' Magazine,* March 1957, pp. 156-168.

"The Inadequacy of Financial Accounts—from the Standpoints of Shareholders and the Public" by W. T. Baxter. *The Accountants' Magazine,* February 1957, pp. 80-90.

"Government Accounts and Social Accounting" by R. L. Mathews. *The Australian Accountant,* January 1957, pp. 35-50.

"Church Accounting" by Lowell E. Larson. *The Journal of Accountancy,* May 1957, pp. 28-35.

Auditing

"The Independent Auditor and Internal Control" by G. R. Byrne, *L.R.B. & M. Journal,* January-March 1957, pp. 8-18.

"The Public Accountant and Punched Card Accounting" by E. A. Harris. *L.R.B. & M. Journal,* July-September 1956, pp. 14-22.

"Small Loan Company Audits" by Robert R. Hudson. *The Journal of Accountancy,* May 1957, pp. 42-45.

Budgeting and Forecasting

"Accountant's Business with Business Forecasting" by H. G. Engler. *NACA Bulletin,* May 1957, pp. 1093-1098.

Equipment

"The Necessity of Electronic Thinking" by B. E. Wynne. *NACA Bulletin,* May 1957, pp. 1141-1149.

Cost Accounting

"Why Not Operate a Capital Budget?" by R. G. Mulle. *Cost and Management,* April 1957, pp. 138-146.

Finances

"Thoughts on Investing" by E. P. Plumridge. *The Accountant,* April 6, 1957, p. 386.

"Stock Splits in a Bull Market" by C. Austin Barker. *Harvard Business Review,* May-June 1957, pp. 72-79.

Management Accounting

"The Place and Functions of Accounting in Management" by E. A. Burley. *The Australian Accountant,* February 1957, pp. 99-110.

"Introduction to Managerial Accountancy" by G. Moller. *The Commerce Journal,* February 1957, pp. 47-58.

Professional

"Safeguarding Executive Health" by Lydia Strong. *The Management Review,* May 1957, pp. 58-73.

Statistics

"Statistical Techniques for Financial Planning and Forecasting" by A. Vazsonyi. *The Controller,* May 1957, p. 216 et seq.

BY J. E. SMYTH, F.C.A.

Students Department

Associate Professor,
Queen's University

CORRESPONDENCE

Vancouver, B.C.

Sir: I should like to offer some very strong advice to students who are or may later be contemplating moving to another province with the intention of resuming studies following the move.

No two of the Provincial Institutes have identical requirements as to courses and examinations, and no provision exists for a transfer, as such, of articles or registration between Institutes. A move entails severing connections with the old Institute and starting afresh with the new — with the *possibility* of receiving partial or total credit for courses and examinations passed.

A student wishing to move to another province should therefore determine from his present Institute:

(a) what credit, already earned or partially earned, might he lose (as to both courses and examinations);

and from the intended Institute:

(a) what credit would he receive for past service as a student,

(b) at what course level would he be required to enroll,

(c) what examinations would he be required to take,

(d) what time of year would be best for a move (course commencement and enrolment closing dates, maximum employment opportunity, etc.)

(e) whether, in the case where he is eligible to write, say, the intermediate uniform examination with his present Institute, he would be accorded equal eligibilty as a candidate of the intended Institute.

Failure to check these points *before* moving could cost up to a year's loss of time.

D. C. R. HORNE, C.A., F.C.I.S.,
Secretary-Treasurer,
The Institute of Chartered Accountants of British Columbia.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants, and reflect the personal views and opinions of the various contributors. They are not designed as models for submission to the examiner but rather as such discussion and explanation of the problems as will make their study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, October 1956

Accounting II, Question 3 (15 marks)

On April 1, 1956, G purchased for $6,000 a small grocery business operated by Y. On that date Y's balance sheet showed:

Assets		Liabilities	
Accounts receivable	$2,700	Accounts payable	$3,000
Stock on hand	500	Capital Y	5,300
Delivery truck	600		
Equipment	4,500		
	$8,300		$8,300

During the three months ended June 30, 1956, G did not keep a complete double entry record of his transactions. A record of his bank deposits for the three months ended June 30, 1956, showed the following:

(i) Loan from bank	$ 6,000
(ii) Current sales	36,605
(iii) Collections of outstanding receivables taken over from Y	1,830
(iv) Received from collection agency	240
	$44,675

Uncollected receivables taken over from Y, amounting to $870, were placed in the hands of a collection agency. By agreement, the agency remitted 50% of the accounts collected. The balance of the accounts was considered uncollectible.

A record of cheque stubs showed the following disbursements for the three months ended June 30, 1956:

(1) Cash payment on purchase price	$ 4,000
(2) Payment of accounts payable taken over from Y	3,000
(3) Purchase of additional equipment	660
(4) Personal expenses and drawings	980
(5) X Motors Ltd. for new truck (net after trade-in allowance of $650 on old truck)	1,340
(6) Payment of balance of purchase price	2,000
(7) Repayment on bank loan	1,000
(8) Purchases of merchandise	30,155
	$43,135

Miscellaneous expenses amounting to $1,141 were paid out of cash received from current sales.

On June 30, 1956, purchase invoices unpaid amounted to $2,087; accounts receivable outstanding amounted to $1,650; and the merchandise on hand cost $3,489.

Depreciation is to be provided on a straight-line basis on the closing balances in the asset accounts as follows:

Equipment	10% per annum
Delivery truck	20% per annum

Required:

The statement of profit and loss for the three months ended June 30, 1956, and balance sheet as of that date. (Submit details of your computations).

A SOLUTION

G GROCERY

STATEMENT OF PROFIT AND LOSS

for the three months ended June 30, 1956

Sales		$39,396.00
Cost of Sales		
Inventory, April 1, 1956	$ 500,00	
Purchases	32,242,00	
	$32,742.00	
Inventory, June 30, 1956	3,489.00	29,253.00
Gross profit on sales		$10,143.00
Expenses		
General expenses	$ 1,141.00	
Bad debts written off	390,00	
Collection expense	240.00	
Depreciation — delivery truck	99.50	
Depreciation — equipment	129.00	1,999.50
Net profit on operations		$ 8,143.50
Profit on sale of truck		50.00
Net profit for three months		$ 8,193.50

G GROCERY

BALANCE SHEET AS AT JUNE 30, 1956

ASSETS

Current assets			
Cash in bank		$ 1,540.00	
Accounts receivable		1,650.00	
Stock in trade, at cost		3,489,00	
Total current assets			$ 6,679.00
Fixed assets			
Delivery truck, at cost	$ 1,990.00		
Less allowance for depreciation	99.50		
		1,890.50	
Equipment, at cost	5,160.00		
Less allowance for depreciation	129.00		
		5,031.00	
Total fixed assets			6,921.50
Goodwill, at cost			700.00
			$14,300.50

LIABILITIES AND CAPITAL

Current liabilities		
Bank loan	$ 5,000.00	
Accounts payable	2,087.00	
Total current liabilities		$ 7,087.00
Capital — G		
Net profit for three months to date	8,193.50	
Less drawings	980.00	
Balance June 30, 1956		7,213.50
		$14,300.50

Examiner's Comments

1. More than half of the candidates calculated depreciation expense for a full year instead of for three months as required.
2. A number of candidates assumed that an allowance for doubtful accounts had been provided, although this was not stated in the question.
3. Solutions in which bad debts and collection costs, and profit on disposal of the truck were charged against and credited to capital account respectively, instead of being shown on the profit and loss statement, were regarded as acceptable.
4. Candidates were not penalized if they credited the profit on disposal of the delivery truck to the cost of the new truck, instead of to profit and loss account.

PROBLEM 2

Final Examination, October 1956

Accounting II, Question 4 (22 marks)

The bookkeeper at the B Municipality's office has prepared the following summary of cash receipts and disbursements for the year ended June 30, 1956:

B MUNICIPALITY

SUMMARY OF CASH RECEIPTS AND DISBURSEMENTS

for the year ended June 30, 1956

RECEIPTS

Balance in bank – current (June 30, 1955)	$ 26,500
Balance in bank – street lighting project (June 30, 1955)	11,400
Balance in bank – sinking fund (June 30, 1955)	200
Taxes	85,475
Interest on overdue taxes	3,500
Water rates and licences	5,450
Sale of $20,000 4½% 10 year debentures for street lighting project	19,000
Sinking fund interest	6,700
Recovered from Provincial Government re relief costs	1,450
	$159,675

DISBURSEMENTS

Administrative expenses	$ 16,850
Bank interest – street lighting project	300
Bank loan – street lighting project	20,000
Maintenance – public works	6,500
Maintenance – buildings	1,375
Sinking fund investments purchased	10,300
Relief costs	4,160
Health and sanitation	3,900
Street lighting project construction	11,200
Hospital grant	3,000
School boards (share of current tax levy)	27,000
Debenture interest	14,375
Debentures redeemed	15,000
Balance in bank – current (June 30, 1956)	25,549
Balance in bank – sinking fund (June 30, 1956)	166
	$159,675

The following information is available:

(i) The cost of capital assets, excluding current street lighting project, acquired out of the proceeds of debentures was $425,000.

(ii) The following amounts of the debentures, issued to finance these capital assets, were outstanding as at June 30, 1956:

(1) 5%-15 year serial debentures – principal repayable in annual instalments of $15,000 July 1, 1949 to 1963 – interest payable July 1 and January 1 ..... $120,000

(2) 4%-30 year sinking fund debentures – due July 1, 1959 – interest payable July 1 and January 1 ..... $200,000

All of the debentures had been sold at par.

(iii) According to the terms of issue of the sinking fund debentures, a sinking fund was to be set up for the redemption of the bonds by annual appropriations from the current levy. The funds so appropriated were to be invested in authorized bonds at the discretion of the council. Income thereon was to be retained in the sinking fund.

(iv) As at June 30, 1956, sinking fund investments costing $177,900 had been purchased.

(v) Construction of the new street lighting project had been commenced on April 30, 1955, at which time $20,000 was borrowed from the bank. Up to June 30, 1955, a total of $8,500 had been paid on this construction and interest of $100 had been paid on the bank loan.

(vi) The street lighting project was completed on December 30, 1955. On January 1, 1956, $20,000 $4\frac{1}{2}\%$-10 year serial debentures were issued and sold. The principal is repayable in annual instalments of $2,000 commencing July 1, 1957. Interest is payable semi-annually on July 1 and January 1.

(vii) On January 1, 1956, the bank loan plus interest accrued thereon was repaid to the bank. The excess cash required to repay the loan and interest was advanced from current funds.

(viii) Interest paid on the bank loan was capitalized as part of the cost of construction of the street lights.

(ix) The current tax levy for the year ended June 30, 1956 provides for the following items, in addition to the requirements for general purposes:

Education	$27,000
Debenture principal	15,000
Debenture interest	14,450
Sinking fund requirements	3,566

(x) During the year ended June 30, 1956, discounts of $2,525 were allowed on payment of current taxes.

(xi) The following amounts were outstanding as at June 30, 1955 and 1956:

	As at *June* 30, 1955	*As at* *June* 30, 1956
Taxes receivable	$3,300	$5,300
Interest receivable on overdue taxes	125	150
Interest accrued on sinking fund investments	160	234
Accounts payable re administrative expenses	800	700

(xii) The balance of revenue surplus as at June 30, 1955 was $21,750.

Required:

The balance sheets of the B Municipality as at June 30, 1956 and the statement of revenue and expenditure for the year ended on that date for presentation to the council.

A SOLUTION

B MUNICIPALITY

Statement of Revenue and Expenditure

for the year ended June 30, 1956

REVENUE			
Tax levy		$ 90,000	
Less specific appropriations:			
Education	$ 27,000		
Debenture principal	15,000		
Debenture interest	14,450		
Sinking fund requirements	3,566		
		60,016	
		29,984	
Interest on overdue accounts		3,525	
Water rates and licenses		5,450	
Total revenues			$ 38,959

EXPENDITURE

Discount on current taxes	2,525	
Administration	16,750	
Maintenance — public works	6,500	
Maintenance — buildings	1,375	
Relief costs	2,710	
Health and sanitation	3,900	
Hospital grant	3,000	
Total expenditures		36,760
Excess of revenues over expenditures		$ 2,199

For balance sheet see page 166.

Examiner's Comments

The most common errors made by candidates were:

1. The assumption that a work sheet was necessary.
2. A failure to distinguish between the various funds.

PROBLEM 3

Final Examination, October 1956

Accounting II, Question 5 (16 marks)

M Co. Ltd. produces toys for national distribution. The management has recently established a standard cost system to control costs and set the selling price of toys at 150% of standard cost.

The accountant has not previously prepared financial statements using cost standards and the manager is not familiar with the term "variance", its use, or its application as a control. They come to you for advice.

Established standard costs are:

(i) Material: 10 pieces per unit at 60c per piece.
(ii) Labour: 2 hours per unit at $2.50 per hour.
(iii) Factory service: $5,600 per month, which is applied at 100% of labour cost.

During the month of September 1955, the company produced and sold 1,000 units of finished goods. There were no inventories at the beginning or end of the month. To produce each unit the actual costs were:

(1) Material: 11 pieces at 50c per piece.
(2) Labour: 2.3 hours at $3 per hour.
(3) Factory service: $6.

Required:

Your calculation of the unit selling price and of the favourable or unfavourable variances, resulting from the month's production, together with a brief explanation of the significance of each variance.

B MUNICIPALITY

BALANCE SHEET AS AT JUNE 30, 1956

Assets			Liabilities and Surplus		
CAPITAL FUND					
Capital assets, at cost	$425,000		Debentures payable:		
Less debentures redeemed to date	105,000		5%–15 year serial debentures, repayable in annual instalments of $15,000 July 1, 1949 to 1963	$120,000	
		$ 320,000	4%–30 year sinking fund debentures, due July 1, 1959	200,000	
Street lighting project, at cost		20,100	4½%–10 year serial debentures, repayable in annual instalments of $2,000 July 1, 1957 to July 1, 1966	20,000	
Total capital assets		340,100			$340,000
Debenture discount		1,000	Due to revenue fund		1,100
		$341,000			$341,100
REVENUE FUND					
Cash	$ 25,549		Liabilities:		
Accounts receivable	5,450		Accounts payable	700	
Due from Capital fund	1,100		Debenture interest payable	7,450	
		$ 32,099	Total liabilities		$ 8,150
			Surplus:		
			Balance June 30, 1955	21,750	
			Add excess of revenues over expenditures for the year	2,199	
			Balance June 30, 1956		23,949
		$ 32,099			$ 32,099
SINKING FUND					
Cash	$ 166		Reserve fund:		
Investments, at cost	177,900		Balance June 30, 1955	$167,960	
Interest accrued	234		*Add* current tax appropriation	3,566	
		$178,300	interest earned on investments	6,774	
		$178,300	Balance June 30, 1956		$178,300

A SOLUTION

M CO. LTD.

Calculation of Unit Selling Price

Material cost, at standard – 10 pieces at .60	$ 6.00
Labour cost, at standard – 2 hours at $2.50	5.00
Factory service, at standard – 100% of labour	5.00
Total standard cost	16.00
Add 50%	8.00
Unit selling price	$24.00

Calculation of Variances for the Month of September, 1955

MATERIAL PRICE VARIANCE

Price paid, per unit	.50	
Standard cost	.60	
Economy	.10 on 11,000 pieces	$1,100 (favourable)

This variance shows the influence on cost of a reduction in prices. It may be explained by a purchase of standard grade material at less than standard prices; or it may be explained by a purchase of lower grade material requiring a larger quantity to produce a unit.

MATERIAL QUANTITY VARIANCE

Quantities used	11,000 pieces	
Standard	10,000	
Excess quantity	1,000 pieces at standard (.60)	$ 600 (unfavourable)

This variance shows separately the increase in cost due to an increase in the quantities used. It may be explained by poor control in the use of the materials so that standards could not be met. Because the price paid was lower, it is also possible that the quality of the material was inferior.

LABOUR PRICE VARIANCE

Price paid	$3.00 per hour	
Standard	2.50	
Increase of	.50 for 2,300 hours	$1,150 (unfavourable)

This variance shows the effect on cost of an increase in the hourly rate, as compared to the standard rate. It may be explained by an increase in wages, by poor scheduling of production resulting in overtime work, or by the use of high calibre personnel commanding higher wages.

LABOUR EFFICIENCY VARIANCE

Hours worked	2,300 hours	
Standard	2,000	
Increase of	300 hours at standard ($2.50)	750 (unfavourable)

This variance shows the effect on cost of an increase in the number of hours worked, as compared to the standard time required to produce 1,000 units. It may be explained by poor selection of workers, improperly trained workers, poor

supervision, poor quality of material requiring more labour in the processing, or inadequate tools or machine troubles.

FACTORY SERVICE BUDGET VARIANCE

Actual cost for month	$6,000	
Estimated standard for month	5,600	
Increase of		$ 400 (unfavourable)

This variance shows the effect on cost of an increase in the overhead cost, as compared with standard cost at the normal level of production ($\frac{\$5,600}{2.50}$ = 2,240 hours).

It may be explained by a wrong estimate in the overhead charges for the month, and may be corrected in the next month when the analysis shows the nature of the error.

FACTORY SERVICE EFFICIENCY VARIANCE

Overhead applied on the basis of 100% of labour cost – 2,300 hours at $3	6,900	
Charged to cost at standard – 2,000 hours at $2.50	5,000	
		1,900 (unfavourable)

This variance is explained by the increase in labour costs during the month, on which the factory service applied is based, viz.,

Increase in labour price – 2,000 hours at ($3.00 – $2.50)	$1,000
Increase in hours worked – (2,300 – 2,000) at $3	900
	$1,900

FACTORY SERVICE CAPACITY VARIANCE

Factory service applied – 2,300 hours at $3	$6,900	
Standard factory service at normal level of production – 2,240 hours at $2.50	5,600	
Factory service over-applied caused by plant working in excess of normal level of production		$1,300 (favourable)

Editor's Notes

(1) In the editor's opinion the factory service efficiency variance and the factory service capacity variance might have been computed differently, as follows:

Factory service budget variance (as in above solution)	$ (400)
Factory service efficiency variance	
Actual – 2,300 hours	
Standard – 2,000 hours	
Excess – 300 hours @ $2.50	$ (750)
Factory service capacity variance	
Actual – 2,300 hours	
Budgeted – 2,240 hours	
60 hours @ $2.50	$ 150
Gain from operating at more than normal capacity	
Total factory service variances, net unfavourable	$(1,000)

By either solution, the total factory service variances are the same, that is, the excess of actual factory service ($6,000) over standard factory service for 1,000 units (2,000 hours at $2.50 = $5,000).

Readers are referred to Specthrie: *Basic Cost Accounting*, pages 236 - 239. Specthrie uses the term "factory burden quantity variation" for what the above solution refers to as "factory service efficiency variance" and states "The excess and saved hours *priced at the normal burden rates* are, respectively, the unfavourable and favourable burden quantity variations for the period. The actual hours *priced at the normal burden rate* is the factory burden applied in the period at the normal burden rate." (italics added).

(2) The entries to record the factory service cost would be as follows, following Specthrie:

		Solution I		Solution II	
		Dr.	*Cr.*	*Dr.*	*Cr.*
1955					
Sep. 30	Factory service – actual	6,000		6,000	
	Bank		xxx		xxx
	Accrued liabilities		xxx		xxx
	Allowance for depreciation		xxx		xxx
	To record actual cost				
Sep. 30	Factory service in process	5,000		5,000	
	Factory service efficiency variance	1,900		750	
	Factory service applied		6,900		5,750
	To charge factory service in process with the standard factory service cost of 1,000 units at normal level of operations (2,000 hours at $2.50)				
Sep. 30	Factory service budget variance	400		400	
	Factory service applied		400		400
	To record budget variance per schedule				
Sep. 30	Factory service applied	1,300		150	
	Factory service capacity variance		1,300		150
	To record capacity variance, per schedule				
Sep. 30	Factory service applied	6,000		6,000	
	Factory service actual		6,000		6,000
	To close these accounts				

NEWS OF OUR MEMBERS

Alberta

David Halpern, C.A. announces the removal of his office to 605 Imperial Bank Bldg., Edmonton.

Harvey W. Bliss, C.A. has been recently appointed French Trade Secretary for Alberta.

Nash & Nash, Chartered Accountants, Edmonton, announce the admission to partnership of P. R. Keroack, C.A.

British Columbia

William Clarke, C.A. announces the opening of an office for the practice of his profession at 219 Stock Exchange Bldg., 475 Howe St., Vancouver.

G. W. Woods, C.A. has been appointed vice-president-finance and secretary-treasurer of Balfour Guthrie (Canada) Ltd., Vancouver.

Ontario

George Moller, C.A. spoke to the Finance Orientation Seminar of the American Management Association held in Montreal June 10-12. His subject was "Budgeting on the Basis of Return on Capital Employed".

Campbell, Lawless, Parker & Black, Chartered Accountants, announce the removal of their offices to Rm. 514, 159 Bay St., Toronto.

Fred T. Reisman, C.A. announces the admission to partnership of Sydney Wagman, C.A. Henceforth practice of their profession will be carried on under the firm name of Fred T. Reisman and Sydney Wagman, Chartered Accountants, with offices at 3030 Dundas St. W., Toronto.

E. D. Rushbrook, C.A. has been appointed secretary and treasurer of Canadian Applied Research Ltd., Toronto.

Jack Plumpton, C.A. was elected president of the Hamilton Control, Controllers Institute of America, at the annual meeting. Other chartered accountants elected were George Moller, secretary, and M. S. Sutherland and W. K. Nelson, members of the executive committee.

J. G. Glassco, O.B.E., F.C.A. has been elected to the Board of Directors of National Trust Company.

Quebec

Herve Belzile, C.A. has been appointed managing director of Alliance Nationale Life Insurance Co., Montreal.

Atlas Copco Canada Ltd., Dorval, announces the appointment of W. E. Evens, C.A. as its secretary-treasurer.

R. H. Wood, C.A. has been elected president of the Montreal Control, Controllers Institute of America.

P. S. Ross & Sons, Chartered Accountants, Montreal, announce the admission to partnership of E. J. Newman, C.A., R. M. Rennie, C.A. and J. B. Wight, C.A.

The board of directors of Fraser Companies Ltd., Edmunston, N.B., has announced the appointment of H. M. Logan, C.A. as assistant treasurer of the company and its subsidiaries.

Saskatchewan

Goldie, Hunt & Co., Chartered Accountants, Regina, announce the opening of a branch office for the practice of their profession at Estevan. The resident partner will be D. J. Matchett, C.A.

E. A. Walters, C.A. has been appointed

Director of Municipal Auditing, Accounting and Inspections of the Municipal Affairs Department of the Province of Saskatchewan.

W. H. Boulding, C.A. has been appointed chief accountant of Allied Securities Ltd., Saskatoon.

E. J. Reynolds, C.A. has been appointed chief accountant of the Saskatchewan Power Corporation, Regina.

F. J. Sinnett, C.A. has been appointed Deputy Auditor of Utilities of the Province of Saskatchewan.

OBITUARIES

FRED PAGE HIGGINS

The Ontario Institute announces with regret the death of Fred Page Higgins at Toronto on May 22, 1957 after a long illness.

Born at Pine Grove in 1883, Mr. Higgins was educated at Harbord Collegiate. He was a student-in-accounts with Edwards Morgan & Co., and became a member of the Institute in 1907. Several years later he established his own firm of chartered accountants. Active in Institute affairs, he became president in 1926-27, and in 1935 was elected a Fellow of the Institute for distinguished service to the profession. In March 1957 he was elected a life member in recognition of 50 years of continuous membership in the Institute.

Mr. Higgins served his community faithfully in many ways. As a Kiwanian he became an international vice-president. As a boys' worker he founded a church group called The White Company, and helped enthusiastically with the Boy Scouts and the Big Brothers. He also served on the executive of other groups and was a member of many clubs.

To his wife and family the members of the Institute extend their sincere sympathy.

NORMAN LLOYD DEATH

The Ontario Institute announces with regret the sudden death on May 22, 1957 of Norman Lloyd Death in his 40th year. Mr. Death died of a heart attack as he was leaving his office at the end of the day.

Mr. Death was with the Income Tax Division of the Department of National Revenue in Toronto and had previously been an accountant with the Abitibi Power and Paper Co. in St. Catharines.

Born in Toronto, he attended Parkdale Collegiate Institute and became a chartered accountant in 1942. During the Second World War he served with the R.C.A.F. He was treasurer of the North Parkdale United Church and later with the Applewood Acres United Church.

The members of the Institute extend their sincere sympathy to his wife and young children.

LEMUEL CUSHING

The Institute of Chartered Accountants of Quebec announces with regret the death on June 6, 1957, of Lemuel Cushing in his 82nd year.

Mr. Cushing was born in Cushing, Quebec, and moved to Montreal as a young man where he originally worked for the late George Creak, C.A. Admitted to membership in the Quebec Institute in 1905, he was later taken into partnership with the late Charles Hodgson to form the firm of Creak, Cushing and Hodgson, Chartered Accountants. He retired in 1951.

Mr. Cushing served as president of the Institute of Chartered Accountants of Quebec in 1925-26 and at the time of his death was the oldest living member of that body. He was presented with a silver tray by the

Governor-General at the Institute's 75th anniversary banquet, commemorating the completion, at that time, of 50 years of membership. He was also active in community affairs and keenly interested in curling and other sports.

To his wife and members of his family, the officers and members of the Institute extend their deepest sympathy.

WALTER F. GRAW

The Institute of Chartered Accountants of Quebec announces with regret the death on May 23, 1957, of Walter Frank Graw. Mr. Graw commenced his career in public accounting in Toronto, later coming to Montreal where he became associated with Edwards, Morgan & Co., Chartered Accountants. For many years he was the Montreal resident partner of that firm. He was admitted to membership in the Institute of Chartered Accountants of Quebec in 1924.

To his widow, the officers and members of the Institute extend their most sincere sympathy.

ALFRED LAFOND

L'Institut des Comptables Agréés de Québec a le regret d'annoncer le décès de Monsieur Alfred Lafond le ler avril 1957.

Monsieur Lafond est né et a reçu son instruction à Montréal et de 1924 jusqu'à sa mort, il était associé à la firme de J. A. W. Archambault & Associés, Comptables Agréés. Il a été admis comme membre de L'Institut des Comptables Agréés de Québec en 1947.

A Madame Lafond et à sa famille, les officiers et les membres du Conseil de l'Institut expriment leurs sincères condoléances.

PAUL GAUVIN

L'Institut des Comptables Agréés de Québec a le regret d'annoncer le décès de Monsieur Paul Gauvin, C.A. le 11 mai 1957.

Monsieur Gauvin a fait ses études à Québec et était à l'emploi de la firme LaRue & Trudel, C.A. à Montréal, comme stagiaire. Il a été admis membre en 1938 et, après avoir travaillé quelque temps au département de l'impôt sur le revenu et plusieurs firmes de Comptables agréés, il a ouvert son propre bureau en 1947 et pratiquait seul jusqu'au moment de son décès.

A Madame Gauvin et à sa famille, les officiers et les membres du Conseil de l'Institut expriment leurs sincères condoléances.

GILLES ROLLAND

L'Institut des Comptables Agréés de Québec a le regret d'annoncer le décès de Gilles Rolland de Verdun, agé de 29 ans, survenu le 25 mars 1957.

Gradué de l'Ecole Supérieure Richard de Verdun en 1945, il fut licencié de l'Ecole des Hautes Etudes Commerciales de Montréal en 1949 et licencié en Sciences Commerciales en 1950.

Il devint membre de l'Institut des Comptables Agréés de Québec en 1951.

Il fit son stage chez Rothenberg Luterman & Co. et fut ensuite à l'emploi de Richard Lumber Enrg. à titre de contrôleur.

Les membres de l'Institut expriment leurs sincères condoléances à toute la famille éprouvée.

JOSEPH LOUIS FORTIN

The Institute of Chartered Accountants of Quebec regrets to announce the death on May 29, 1957, of Joseph Louis Fortin.

Mr. Fortin was educated in Saskatchewan and was a graduate in Commerce from the University of Saskatchewan. He became a member of the Institute of Chartered Accountants of Saskatchewan in 1930 and transferred to the Quebec Institute in 1946. He had a varied career both in public practice and in industry, having been for several years assistant treasurer of the City of Yorkton, Sask., From 1938 to the time of his death he was with Price Brothers & Co. Ltd., Quebec City, in later years as its chief accountant.

To his widow and members of his family, the officers and members of the Institute extend their deep sympathy.

INSTITUTE NOTES

ONTARIO INSTITUTE

More than 450 members of the Institute of Chartered Accountants of Ontario turned out for the Institute's second annual two-day conference held on June 17 and 18 at the University of Toronto. The annual general meeting of members on Monday, June 17 was preceded by a panel discussion on management consulting. This was followed by a short presentation by Peter Wright, Q.C. on professional conduct, after which small groups were formed to discuss the application of the Institute's rules of conduct to present day circumstances.

ONTARIO EXECUTIVE 1957-58
M. A. Bradshaw, vice-president; R. B. Dale-Harris, treasurer; W. I. Hetherington, president; J. G. Brown, secretary.

On Monday evening members attended a reception in Convocation Hall, Trinity College, followed by a dinner given in Howard Ferguson Hall at which the guest speaker was Dr. Sidney Smith, Q.C., LL.D., president of the University of Toronto. Dr. Smith spoke on how Canadians can do their share in the development of a realistic public philosophy and decried the thinking of three specific Canadian groups whom he considered stumbling blocks to any such development. He said, in part:

"I should like to depict for you three Canadians. The first is the 'little Canadian', who wants to keep Canada to himself. Immigration makes him boil with indignation. He would like to establish a special category of native sons

W. I. Hetherington and J. R. M. Wilson with Joyce Davidson before their appearance on "Tabloid".

and regards new Canadians as slightly second class. His grandfather was an immigrant but what was good enough for grandfather is not too good for anyone else. The second is the 'pseudo Canadian'. He is Canadian by birth and residence, but that is all. For him there is no free trade of ideas. He abides by a most favoured nation clause and gets all his ideas from American magazines. Canadian magazines are no good — he knows; he never reads them. His entertainment comes from American movies, radio and TV. C.B.C. programs are no good — he knows; he never tunes them in. He bemoans the fact that there is no Canadian literature — he knows; he has never read a novel by Morley Callaghan or Gabrielle Roy or a play by Robertson Davies or a poem by E. J. Pratt. He has never taken a trip to Halifax with its shipping or Quebec with its Citadel or the Stratford Festival, Win-

nipeg, Banff or Vancouver; when he goes on holiday he cannot get out of Canada fast enough. He found Canadian history dull in school and has never read a word of it since. His opinions are completely governed by what he thinks will make his business good in his locality. About the problems and needs of other parts of Canada he could not care less. Then there is the third — the 'blowhard Canadian'. We are now riding the crest of a wave of economic prosperity. We have always had a wealth of natural resources, but it has taken the scientific advances of half the 20th century to make it fully exploitable. The blowhard Canadian never talks about anything else.

BETWEEN SESSIONS
***Left to right*: J. L. Shortly, Toronto; W. W. Pollock, St. Catharines; S. G. Cruttenden, St. Catharines; D. B. Crawley, Toronto; Jules Newman, Toronto; H. A. Stone, Toronto. *Standing*: G. H. Spence, Toronto.**

"Two documents illustrate the meaning of the development of a public philosophy. One is the Report of the Royal Commission on National Development in the Arts, Letters and Sciences, familiarly known as the Massey Report. The other, so far just a preliminary report, was issued by the Royal Commission on Canada's Economic Prospects under the chairmanship of Mr. Walter Gordon, an eminent member of your Institute. The tone of those reports is confident without being blowhard, realistic without the deprecation of the pseudo-Canadians, patriotic without the jingoism of little Canadianism. The commissioners did not grind the constitutional axes of province versus nation or province versus province. They sought ways and means of strengthening the whole and the parts together. Those reports should be on the bookshelves of every thinking Canadian.

"A broad perspective and a reasonable far-sighted conduct of affairs are not matters that depend on government enactments. They depend on the behaviour of individuals who have, as an ever-present factor in their plans and calculations, the good of the nation."

Six concurrent group discussions on municipal accounting, mining and oil accounting, estate planning, the significance of internal control, mechanized accounting, and costing procedures for small size manufacturing companies were among those held on Tuesday morning. A panel discussion on Bulletin No. 10 (depreciation, capital cost allowances and income tax) and a symposium on income tax were the subjects discussed during the afternoon sessions.

W. I. Hetherington was elected president for the year 1957-58. Other officers elected were vice-president, M. A. Bradshaw, Toronto; secretary, J. G. Brown, Kitchener; treasurer, R. B. Dale-Harris, Toronto.

Despite a blistering heat wave, which sent the temperature on both days to 92°, general discussion was vigorous and the speakers engaged their listeners' interest, which can be considered as a sure indication that the conference was a complete success.

Administrative Development Program: The Institute of Business Administration of the University of Toronto has announced that evening classes will be held from October to March for those who are preparing themselves for increased responsibilities. Weekly classes will be held in administrative practices, financial management, marketing, human relations, industrial relations, managerial economics, production management, personnel psychology, marketing and distribution research. Application forms may be obtained from the Institute of Business Administration, 273 Bloor St. W., Toronto.

NEW B.C. EXECUTIVE
Left to right: G. O. Cumpston, immediate past president; A. D. (Peter) Stanley, president; G. M. Miller, vice-president.

B.C. INSTITUTE

Officers elected by the B.C. Institute at its annual meeting on June 13 - 14 were A. D. Stanley, president and G. M. Miller, vice-president. Edward L. Affleck is the newly-appointed secretary-treasurer of the Institute.

At a luncheon on June 14 Fellowships were presented to three past presidents, G. Fitzpatrick Dunn, Victoria; D. R. Lukin Johnston, Vancouver; and W. R. C. Patrick, Vancouver.

The meeting was combined with a conference at which a number of technical papers were presented. Wm. M. Mercer gave an address on "Pensions for the Self-Employed", and Ian Shaw, vice-president of the Vancouver Bar Association, spoke on "Accountants and the Legal Professions Act". There was also an address by Charles A. Perry, Deputy Commissioner of Income Tax in the Government of British Columbia. on the Mining and Logging Tax Acts.

A dinner and dance concluded the 2-day conference.

ALBERTA INSTITUTE

The annual meeting of the Alberta Institute was held in Calgary on Thursday and Friday, June 20 and 21.

Technical sessions were held throughout Thursday at the new Jubilee Auditorium. Luncheon was served there and visiting members were conducted on a tour of the building during the noon intermission. One hundred and fifty persons attended. The program of technical sessions was as follows:

***Estate Planning*:**
Chairman, Eric Connelly.
Panel Members, J. G. Hutchison, R. J. Burns, A. H. Todd, F. H. Larson and C. Oates.

***Pensions for the self-employed*:**
R. D. Purvis

***Trends in financial statement presentation*:**
Chairman, R. A. Wilson
Panel Members, H. W. Bliss and D. A. McKay.

***Forum-Problems in industry and in practice*:**
Chairman, D. A. Ross
Panel Members, J. R. Fish, F. Gordon-Cooper and J. S. McGibbon.

On Thursday evening members and their ladies were guests of the Calgary Chartered Accountants Club at a barbecue held in a traditional western setting at a ranch south of the city.

Friday morning and part of the afternoon were devoted to formal Institute business, the sessions being held in the Hotel Palliser. The meeting received reports of

ELECTED B.C. FELLOWS
W. R. C. Patrick, G. Fitzpatrick Dunn and D. R. Lukin Johnston study the Fellowship certificates presented to them at the annual meeting of the B.C. Institute, June 13-14.

committees and approved a number of changes in by-laws, to increase the number of Council members from nine to twelve, effective from the next annual meeting.

At the annual luncheon, Fellowships were awarded to Eric Connelly, Alexander J. Hamilton and Allan D. McTavish. Mr. B. W Gillespie, vice-president of Home Oil Limited, gave a delightful account of a geologist's experiences in the jungles of the Amazon.

A reception and dinner dance on Friday evening brought the meeting to a close.

Council members and officers elected for the year 1957-58 are: president, J. G. Simonton; vice-presidents, Gilbert E. Gee and J. A. Williams; secretary, R. E. Waller; treasurer, H. G. Thomson; Other Council members, D. B. Barr, D. A. McGregor, D. J. Morrison and B. F. L. Symes.

A. D. McTavish was re-appointed executive secretary.

SASKATCHEWAN INSTITUTE

Eighty-three members attended the annual meeting of the Saskatchewan Institute on June 22 at the Hotel Saskatchewan, Regina. Ian Forbes, president, pointed to the growth of the Institute during the year, with 29 additions to membership. H. Austin Hunt was elected a Fellow of the Institute.

R. C. Hodsman was elected president and G. E. M. Harris vice-president for the coming year. Thos. H. Moffet was reappointed honorary secretary.

The meeting was followed by a golf tournament, and in the evening members and their ladies were guests of the Regina Chartered Accountants Club at a cabaret dance.

NEWFOUNDLAND INSTITUTE

At its annual meeting on June 28, E. M. Hunter was elected president of the Newfoundland Institute for the coming year. Elected to Council were: J. A. Reynolds, vice-president; S. N. Inkpen, secretary-treasurer; J. Hyslop, J. C. Newland, C. W. Earle, A. C. Lloyd Hudson, R. Leith and F. D. Woolgar.

QUEBEC INSTITUTE

Annual Meeting: The retiring president, Lucien D. Viau, reported to the annual meeting that the Quebec Institute, at April 30, 1957, totalled 2,414, a net increase of 153 during the year.

The activities of the Conduct and Discipline Committee, he added, showed clearly that the provincial council is taking a positive stand both on the professional conduct of Institute members and in cases where persons may attempt to practice without proper professional authority.

Mr. Viau said the provincial Institute is undertaking a particularly active public relations program, an important aspect of which is in recruitment of student accountants. There is still room for improvement in member-cooperation with regard to recruitment.

Mr. Viau also referred to the Quebec Institute's first annual provincial conference, which was held in conjunction with the annual meeting. "Judging from the interest shown in the conference," he said, "it seems most members favour the idea, and I, personally, hope it is one we shall continue in the future."

Provincial Conference: More than 400 members attended the one-day provincial conference at the University of Montreal on June 12.

Subjects, selected to interest chartered accountants in industry and commerce as well as those in private practice, were discussed at bilingual sessions and by separate groups conducted in French and English.

Msgr. Irenéé Lussier, Rector of the University of Montreal, welcomed members at the opening ceremony. The retiring president of the Institute, Lucien D. Viau, presided, and Henri L. Bélanger, chairman of the conference committee, outlined the program.

The first forum dealt with "The Preparation of Statements for use in Prospectuses and Filing with the Quebec Securities Commission." Separate sessions were held in English and French and Marcel St. Denis of the Quebec Securities Commission was

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Quebec City Delegation ↑

First row: Michel Motard, Miss Thérèse Robichaud, Guy Fortier, Albert Garneau, Maurice DeCoster. *Second row*: Georges Lachance, Gaston Robitaille, Paul-André Lachance, Bernard Proulx, André Gagnon, Marcel Robert, Marius Laliberté. *Third row*: Gérard Beaulieu, Bertrand Dumais, Yvan Nadeau, Roger Morin.

New Quebec Institute Officers

Left to right: Lucien D. Viau, immediate past president; Howard I. Ross, 1st vice-president; George P. Keeping, president; J. Emile Maheu, 2nd vice-president; M. Laird Watt, secretary. Not present, Leo E. Boissonnault, treasurer.

A group from Sherbrooke ↑

Left to right: Jean-Guy Lanctôt, Philippe Saint-Jacques, Charles-Emile Belanger, Yvon Sirois, Pierre Comtois.

Lucien D. Viau presents an engraved silver tray to S. R. Campbell (left) in recognition of his 50 years as a chartered accountant. The event took place at the Quebec Institute annual dinner on June 12. →

present to answer questions. Chairmen of the sessions were F. T. Denis and Paul-E. Courtois, respectively.

The forum discussed certain important differences between the Quebec, Ontario and Federal legislation governing prospectuses.

A bilingual forum dealt with the subject, "The Application of Electronic and Mechanical Accounting Methods to Medium-Sized Companies." E. A. Lemieux was chairman.

Before the afternoon sessions, members had the opportunity to tour the modern buildings of the University of Montreal, which are attractively situated on the northern slopes of Mount Royal.

The remainder of the program consisted of eight discussion groups — four in English and four in French. English-language members discussed modern audit methods, forms control and the retention and destruction of records, and the audit of and retention of controls in mechanized accounting systems. Discussions in French covered some of the various problems encountered in the audit of municipalities, the functions of an internal audit department and its relations to the external auditor and the administration of a professional office with emphasis on student training. Another important topic, the education and training of chartered accountants for positions of responsibility in industry and commerce, was discussed at separate sessions in both languages.

Annual Dinner: The guest speaker at the annual dinner was Dr. Henry F. Hall, B.A., L.R.E., principal of Sir George Williams College, who said, in part:

"It is well known that professions are constantly demanding higher standards of education. There is, however, a marked trend toward the wider acceptance of the concept of general education as fundamental to occupational training. This has many bases. One is that occupations of professional and semi-professional level are becoming more and more specialized. It is, therefore, impossible for professional faculties or training schools of any sort to prepare students in the details of their future work. On the other hand there is a growing recognition of the fact that such basic qualities as knowledge of the world in general, ability to adjust to and cooperate with others and, above all, sound character, are important not only in home and community but also in the practice of one's profession.

"It does not become me to advise you regarding policy of training and qualification for your profession. The fact that accountants have played leading roles not only as accountants, but in the broader aspects of management, government and industry, speaks for itself. I hope, however, that as changes are made, you will keep in mind the claims of general education as a background for, at least, potential leaders of your profession.

"Two principles are fundamental in the direction and operation of an educational enterprise. They are both simple in concept but difficult to execute. Most of our educational problems, however, (except that of finance) derive from the neglect or oversight of these two principles. The first is that education is primarily concerned not with knowledge, but with the development of people. This is easy to say, and most educationalists agree with it, but it is hard to practise because it consists of such factors as attitudes, abilities and skills, which are really habits of thought and action. Here professional education can make, and has already made, a great contribution to general and liberal education. Vague generalities and fundamental platitudes are not good enough, however true they may be, when the accountant is faced with a specific problem in his own field. Here, as elsewhere, experience and ability combine to accomplish the particular task. We who practice general education need to learn the art of teaching students to make knowledge and experience a part of themselves. This is the essential element of good teaching and of sound learning so often replaced by a substitute consisting of memorization of words and formulae, good in themselves, but dead unless living in the minds and characters of people.

"The other principle is that each individual is unique with a particular combination of qualities and possibilities both inherited and acquired. Modern education demands classification, grading, marking and all the other practices which sometimes obscure the fact that the student should be regarded as having the status and dignity (as well as the personal responsibility) of a human character."

QUEBEC CITY C.A.'s

The 22nd annual meeting of the Quebec City Committee of the Institute of Chartered Accountants of Quebec was held on June 8 at the Manoir St. Castin, Lake Beauport.

Officers elected for 1957-58 were: president, Albert Garneau; vice-president, Godfrey Gourdeau; secretary-treasurer, Roger H. Stanton; directors, Raymond Fortier, Gérard Renaud, Jules Bélanger, Roger Roy and Robert Noel. Paul R. Thivierge is immediate past president.

QUEBEC STUDENTS

The Quebec Institute Students Society held its annual meeting on June 19, when the following officers were elected: honorary presidents, Lucien D. Viau, C.A., George P. Keeping, C.A., M. Saint-Denis, C.A.; president, Morton Hersh, C.A.; vice-presidents, J. André Coté, C.A., George G. Murray, C.A.; secretary-treasurer: Raymond L. Hébert, C.A.

Members of committee: Arthur Beaudoin, Peter L. Beckett, David A. Brown, Barry Clamen, Mortimer Davis, C.A., Pierre J. Dufresne, Issie Farbarowitch, Henry J. Garbacz, C.A., Bernard Lachapelle, Louis Lacourse, C.A., Donald R. Lambton, Norman P. Leblanc, Donald A. Reed, Kenneth C. Stilwell, C.A., Edwin David Weldon.

Representing the Institute are André G. Leroux, C.A.; D. F. Rennie, C.A.

* * * *

The Quebec Students Society has organized evening coaching courses in accounting and auditing to aid students writing their intermediate and final examinations this fall. Courses will be held at McGill University under the direction of Peter C. Briant, C.A., and at L'Ecole Des Hautes Etudes Commerciales under J. J. St. Pierre, C.A. Courses at McGill commenced on July 8 and at L'Ecole on June 13. Enrolment in the courses totals 60 intermediates and 90 finalists.

* * * *

The Students Society Golf Day at the LaSalle Golf and Country Club on June 20 attracted a crowd of 160 members. W. D. Quale won the gross prize with a neat 77 and D. F. Sharpe the low net with a sharp 56½.

C.A. CLUB OF OTTAWA

A successful golf tournament was held at the Royal Ottawa Golf Club on June 11, 1957. Seventy-five chartered accountants participated and over 80 attended dinner at the club. The Price Waterhouse trophy for the low net score was won by F. J. Altimas, and E. D. Martin won the McDonald Currie trophy for low gross.

HAMILTON AND DISTRICT C.A. ASSOCIATION

The annual golf day, dinner and business meeting of the Hamilton and District Chartered Accountants Association was held on June 11 at the St. Catharines Golf and Country Club. Over 50 members played golf, and about 80 were on hand for the dinner and meeting. Elected to the executive committee for the coming year were: W. G. Thompson (chairman), W. C. Chick, L. H. Digby, M. P. Greenhill, S. G. Jackson, L. H. Johnston, W. W. Pollock, C. G. Robinson and H. P. Sellers.

WINDSOR STUDENTS ASSOCIATION

A meeting of the Windsor and District Branch of the Ontario C.A. Students Association heard three speakers discuss opportunities for prospective chartered accountants: S. White, C.A., assistant comptroller of Ford of Canada, R. Meaningwell, C.A. and K. Reid, C.A., director of taxation for Windsor district. These speakers were followed by Rodger Emery, a student, who talked on the duties of a student-in-accounts. Following a discussion period, movies were shown and refreshments served.

CLASSIFIED ADVERTISEMENTS

Rates: *Positions wanted, $7.00 per column inch; Positions offered, $10.00 per column inch; Open rate, $17.00 per column inch.*

All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.

Closing date is 14th of preceding month

CHARTERED ACCOUNTANT WANTED: Opportunity in public accounting. If you are interested in establishing your own practice in a smaller centre in Ontario in association with other practitioners, please contact G. H. Ward, Room 412, 200 Bay Street, Toronto 1, EM. 3-6449. There is a very good opportunity available for a chartered accountant with the right qualifications.

VANCOUVER: Chartered accountants with established practice invite inquiries from firms interested in B.C. representation, perhaps with merger. Box 681.

EXECUTIVE ACCOUNTANT

City of London, Ontario

Sealed applications, addressed to the undersigned, will be received for the position of Deputy City Treasurer of the City of London. Applicants holding a recognized degree in accountancy and having experience in municipal accounting are preferred. Applicants are requested to state age, educational qualifications, training and experience. A photograph not smaller than 3" x 4" is to be attached with application. Salary is subject to negotiation. Duties will entail the direction of accounting procedure and the preparation of budget and financial statements under the direction of the City Treasurer. The following benefits should be noted by applicants: pension plan, sick leave credits, statutory holidays with pay, two weeks vacation after one year and three weeks vacation after ten years.

C. O. LOGAN
City Treasurer.

STUDENT WANTED: Intermediate for office in small town in Ontario. Please contact G. H. Ward, 200 Bay Street, Toronto 1, EM 3-6440.

INTERMEDIATE AND SENIOR STUDENTS required, who are interested in taking up residence in London, Ontario. Perlmutter, Orenstein, Giddens, Newman & Co., 397 Dundas Street, London, Ontario.

A WELL ESTABLISHED Vancouver firm is anxious to obtain the services of a chartered accountant with good experience and personality. There are excellent opportunities for advancement within the firm. Box 684.

SOLE PRACTITIONER IN WINDSOR requires a young chartered accountant or senior student to assume responsibility for part of practice with future partnership possibilities. Reply stating age, education, experience, salary requisite, etc. to Box 683.

CHARTERED ACCOUNTANT, age 36, married, two children, supervisor with national practising firm, seeking responsible position in manufacturing, commercial or service industries, Montreal area, Eastern Townships, Quebec City. Bilingual. Box 682.

ACCOUNTING PRACTICE WANTED: Toronto firm of chartered accountants would like to purchase practice, either outright or partnership agreement. Please state details. Box 685.

FOR SALE: Mid-Western Ontario chartered accountant's practice. Established ten years, good growth history and prospects. Box 680.

BARRISTERS AND SOLICITORS

MACLEOD, McDERMID, DIXON, BURNS, McCOLOUGH, LOVE & LEITCH

Barristers and Solicitors

6th Floor, Hollinsworth Building - - - Calgary, Alta.

PITBLADO, HOSKIN, BENNEST, DRUMMOND-HAY, PITBLADO, McEWEN, ALSAKER, HUNTER & SWEATMAN

Barristers and Solicitors

Hamilton Building, 395 Main Street - Winnipeg 2, Man.

STEWART, SMITH, MACKEEN, COVERT, ROGERS, SPERRY & COWAN

Barristers and Solicitors

Roy Building - - - - - - Halifax, N.S.

ROSS & ROBINSON

Barristers and Solicitors

Canadian Bank of Commerce Chambers - - Hamilton, Ont.

BORDEN, ELLIOT, KELLEY, PALMER & SANKEY

Barristers and Solicitors

25 King Street West - - - - - Toronto 1, Ont.

ALAN DIGNAN, Q.C.

Barrister and Solicitor

1245 Bloor Street West - - - - Toronto 4, Ont.

McCARTHY & McCARTHY

Barristers and Solicitors

Canada Life Building, 330 University Avenue - Toronto 1, Ont.

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